PRINCIPLES OF BOOKKEEPING AND BUSINESS

ADVANCED COURSE

BOWMAN AND PERCY

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PRINCIPLES OF BOOKKEEPING AND BUSINESS

ADVANCED COURSE

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EDITOR'S INTRODUCTION

PRACTICALLY all commercial pupils in secondary schools, both public and private, should study elementary bookkeeping. At least some pupils should pursue this subject into its more advanced phases. However, to make these positions tenable it must be shown that the study of elementary bookkeeping results in something more than mere ability to record business transactions, and that the study of advanced bookkeeping results in a clear comprehension of the fundamental uses which are made of accounting records in business management.

In the preparation of this text the authors have aimed to present those advanced principles of bookkeeping which are used by successful accountants in keeping more elaborate sets of books, and at the same time to reveal the uses which executives make of business records in directing the progress of a successful business enterprise. A reasonable degree of bookkeeping skill is assured by an abundance of practice material included in the text, and a measure of ability to think in accounting terms is made possible through carefully selected accounting problems for classroom discussion. Frequent reviews are provided, thus integrating at certain intervals all that has gone before and fixing in mind principles already learned. The accompanying business practice sets serve also as a test to determine whether or not the pupils have acquired the skill involved in keeping books and such knowledge as is essential to a full understanding of accounting work.

The development of advanced bookkeeping principles in this book proceeds by easy and natural steps, thus making possible a teaching method which is in conformity with sound educational practice. Accounting terminology is used in such a way as to involve the minimal amount of difficulty for the pupil while at the same time helping him to acquire a clear understanding of the principles involved. This terminology is the only language that can be used satisfactorily in dealing with this subject.

It is the conviction of the editor that with such instruction material as is provided in this text it will be possible to obtain from the study of advanced bookkeeping the important values which have long been claimed for this subject, but which often have seemed unattainable.

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PREFACE

THIS text is intended for use as an advanced course in the principles of bookkeeping in public and private secondary schools. The text material is planned to continue in logical order the work of an elementary course in the subject by introducing new principles and a further development of bookkeeping records. It is intended for the use of pupils who have received instruction for at least one year in the principles of bookkeeping. In schools where one year is devoted to junior business practice and a second year to elementary bookkeeping, this text may be used the third year.

The instruction material is so presented that either the class or individual method of instruction may be followed. The practice material is largely in the form of exercises and short problems, thus emphasizing each specific bookkeeping principle as it is presented and providing a constant review of principles previously studied. This text features exercises and short problems because "set" work, if introduced before the required bookkeeping principles are mastered, has a tendency to distract the pupil's attention from principles to the handling of business papers and the recording of routine transactions.

It is the aim of modern bookkeeping instruction to give the student some appreciation of the significance of accounts from the standpoint of management as well as to give him the training that is necessary to become an efficient bookkeeper. To that end the authors have emphasized principles by the use of sufficient practice work to develop the student's power of analysis and, at the same time, give him the technique required for keeping a set of books.

The chapters are comparatively short and are organized as follows:

1. Instruction material presented in simple language and so completely illustrated as to present fundamental principles in such a way as to enable the student to understand the importance of accounts in the solution of business problems.

2. Ample exercise and problem material to assist the pupil in fixing principles in his mind through application and drill.

3. Questions and problems for class discussion to serve as a review of the instruction material.

4. Summaries to emphasize the main principles covered in preceding chapters.

Bookkeeping and accounting features peculiar to partnership and corporate forms of business organization are thoroughly treated and are given the emphasis which their importance demands. The emphasis, however, is placed upon special accounting problems in connection with these types of organization with a minimum of reference to routine transactions with which the pupil is already familiar. Many topics peculiar to partnership and corporations are discussed not so much with the idea that the average pupil will be called upon to apply all the accounting principles applicable thereto, but rather to acquaint him with business customs and usages in these forms of business organization.

To afford practice in applying principles and in operating a complete set of bookkeeping records two sets entirely separate from the text have been prepared. * *Business Practice Set No. 3* may be introduced at the end of Chapter XXIII. This set is based upon the partnership form of organization, and introduces controlling accounts, special columnar journals, etc., and is designed to summarize the work covered to the end of this chapter. *Business Practice Set No. 4* may be introduced at the end of Chapter XXXVI. This set is based upon the corporate form of organization and affords practice in using the voucher system. It summarizes corporate and simple manufacturing procedure.

Throughout the text it is assumed that the student is reasonably familiar with the fundamental principles of bookkeeping and the preparation and use of business papers. Discussion of the various phases of accounting theory is not intended to be exhaustive, but rather to cover the essentials in such a way as to be of practical value to the student and to provide a foundation for more advanced study of accounting.

The authors desire to express their appreciation to the teachers, accountants, and business men who have made constructive suggestions and provided material for use in the preparation of this volume.

* *Business Practice Sets No. 1* and *No. 2* are provided for the Elementary Course.

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PRINCIPLES OF BOOKKEEPING AND BUSINESS

CONTROLLING ACCOUNTS

CHAPTER I

SUBSIDIARY LEDGERS

Purpose of Grouping Similar Transactions. — The recording of all business transactions in one journal limits the amount of bookkeeping work that can be done in one day to the ability of the person making the record. Since in a business of considerable size this limitation is impracticable, the various transactions are classified as to kind, and each class is entered in a special journal. This arrangement not only makes it possible to divide the work of entering transactions among several bookkeepers but also lessens the amount of labor required in making the entries, and reduces considerably the number of items to be posted to the ledger, which decreases opportunities for making errors. Most systems for keeping business records place purchases, sales, and cash items each in a special journal, leaving all other transactions in the original journal, known as the *General Journal*.

Subsidiary Ledgers. — The grouping of similar transactions has been so successfully employed in bookkeeping that not only are purchases and sales transactions placed in separate books of original entry, but separate ledgers are maintained for such transactions so that postings of the same type may be made to the same ledger. A ledger to which entries of the same class or type are posted is known as a *subsidiary* ledger.

The Accounts Receivable Ledger. — Customers' accounts form the largest group of accounts of the same class, in a business of any size. When there is a large number of customers' accounts, it is necessary to divide the work of posting among several clerks. Just as sales transactions are recorded in a special journal so the customers' accounts affected by sales transactions are opened in a special ledger, called the *Accounts Receivable Ledger*. Other titles for this ledger are " Sales Ledger," " Customers' Ledger," and " Debit Ledger."

If the business is very large, the Accounts Receivable Ledger may be made available for a number of bookkeepers by arranging the names of the customers according to geographical location, such as " Eastern Sales Ledger," " Western Sales Ledger," " City Sales Ledger," etc. Or the ledger may be divided alphabetically as A–H, I–R, etc., or according to any other division that may suit the needs of the concern. The foregoing are all known as subsidiary or supporting ledgers.

The Accounts Payable Ledger. — As transactions involving purchases of goods are placed in a special journal, so those personal accounts affected by such transactions are posted to a special ledger. The ledger that contains the accounts of creditors is known as the *Accounts Payable Ledger*. It is also known as the " Purchases Ledger," " Creditors' Ledger " and " Credit Ledger." While this ledger does not contain so many accounts as the Customers' Ledger, it may also be divided so that more than one bookkeeper may work on it at the same time if desired.

The General Ledger. — Just as the journal containing all transactions not entered in the special journals is known as the General Journal, so the ledger containing all accounts except detailed customers' and creditors' accounts is known as the *General Ledger*. A business carrying several hundred accounts employs at least three ledgers — one containing customers' accounts only; another, creditors' accounts only; and a third, all other accounts. However, the trial balance is taken *only* from the General Ledger. The General Ledger reflects the condition of the business as a whole. In order to keep the General Ledger in balance and enable a trial balance to be taken therefrom, an account called *Accounts Receivable* is opened in the General Ledger to contain the total of the customers' accounts transferred from the General Ledger to the Accounts Receivable Ledger; and an account called *Accounts Payable* to contain the creditors' accounts transferred from the General Ledger to the Accounts Payable Ledger. These accounts are said to control the balances in the subsidiary ledgers. The Accounts Receivable account indicates by its balance the sum of the balances of all the customers' accounts; and the Accounts Payable account, the balance of all creditors' accounts.

Controlling Accounts. — A controlling account is an account in the General Ledger which stands for or represents a group of accounts recorded in some subsidiary ledger. Controlling accounts take their names from the name of the subsidiary ledger that they control. The most common examples of controlling accounts are the Accounts Receivable and Accounts Payable accounts. By means of these accounts it is possible for the merchant to obtain a complete statement

of his business from the General Ledger without referring to the Accounts Receivable or Accounts Payable ledgers. Accounts Receivable and Accounts Payable *accounts* must not be confused with Accounts Receivable and Accounts Payable *ledgers*. The former are single accounts in the General Ledger while the latter are special books containing many customers' and creditors' accounts respectively.

Illustration. — Assume that the ledger of B. U. Bates contains the following accounts at the end of a fiscal period and that he desires to transfer his customers' accounts to an Accounts Receivable Ledger and his creditors' accounts to an Accounts Payable Ledger:

Cash			
Balance	1,200.		

Merchandise Inventory			
Balance	2,500.		

Notes Receivable			
Balance	250.		

Office Equipment			
Balance	800.		

C. F. Ames			
Balance	500.		

A. C. Allan			
		Balance	260.

R. S. Brown & Co.			
Balance	275.		

D. O. Bacon			
		Balance	140.

George Collins			
Balance	325.		

C. C. Cameron			
		Balance	350.

Ralph Davis			
Balance	150.		

Notes Payable			
		Balance	600.

A. C. Evans & Co.			
Balance	350.		

B. U. Bates, Capital			
		Balance	5,000.

The entries in the General Journal on the following page are made to adjust the current ledger and transfer the balances of the customers' and creditors' accounts to the special ledgers:

GENERAL JOURNAL

	Accounts Receivable (control acc't)		1600	00		
	C. F. Ames	$500				
	George Collins	325				
	R. S. Brown & Co.	275				
	Ralph Davis	150				
	A. C. Evans & Co.	350				
	C. F. Ames				500	00
	George Collins				325	00
	R. S. Brown & Co.				275	00
	Ralph Davis				150	00
	A. C. Evans & Co.				350	00
	To transfer balances of customers' accounts to an Accounts Receivable controlling account and open accounts in Accounts Receivable Ledger.					

The total of the detailed customers' accounts, $1,600, is posted to the debit side of the Accounts Receivable controlling account in the *General Ledger* and the details to the debit of the various customers' accounts in the *Accounts Receivable Ledger*. The credits are posted to the various customers' accounts in the General Ledger.

A. C.	Allan		260	00		
D. O.	Bacon		140	00		
C. C.	Cameron		350	00		
	Accounts Payable (control acc't)				750	00
	A. C. Allan	$260				
	D. O. Bacon	140				
	C. C. Cameron	350				
	To transfer balances of creditors' accounts to an Accounts Payable controlling account and open accounts in the Accounts Payable Ledger.					

The debits are posted to the various creditors' accounts in the General Ledger. The total of the creditors' accounts, $750, is posted to the credit side of the Accounts Payable controlling account in the *General Ledger* and the details to the credit of the various creditors' accounts in the *Accounts Payable Ledger*.

After posting the above entries, the various accounts with customers and creditors in the General Ledger will balance and be ruled off, and the Accounts Receivable and Accounts Payable controlling accounts take their place. As indicated above, the detailed accounts are posted twice, once to close them in the General Ledger and again to open them in the corresponding subsidiary ledger.

The open accounts in the various ledgers now appear as follows:

GENERAL LEDGER

Cash

Balance	1,200.		

Notes Receivable

Balance	250.		

Accounts Receivable

Balance	1,600.		

Merchandise Inventory

Balance	2,500.		

Office Equipment

Balance	800.		

Notes Payable

		Balance	600.

Accounts Payable

		Balance	750.

B. U. Bates, Capital

		Balance	5,000.

ACCOUNTS RECEIVABLE LEDGER

C. F. Ames

Balance	500.		

R. S. Brown & Co.

Balance	275.		

George Collins

Balance	325.		

Ralph Davis

Balance	150.		

A. C. Evans & Co.

Balance	350.		

ACCOUNTS PAYABLE LEDGER

A. C. Allan

		Balance	260.

D. O. Bacon

		Balance	140.

C. C. Cameron

		Balance	350.

The trial balance taken from the General Ledger *only* is as follows:

B. U. Bates

Trial Balance, (Date)

Cash	1200 00	
Notes Receivable	250 00	
Accounts Receivable	1600 00	
Merchandise Inventory	2500 00	
Office Equipment	800 00	
Notes Payable		600 00
Accounts Payable		750 00
B. U. Bates, Capital		5000 00
	6350 00	6350 00

Proving the Subsidiary Ledgers. — To prove that the subsidiary ledgers are in agreement with the General Ledger a list of the balances of the accounts in each ledger is compiled and the total compared with the balances of the Accounts Receivable and Accounts Payable control accounts as shown in the trial balance.

B. U. Bates

Schedule of Customers' Balances, (Date)

C. F. Ames	500 00	
R. S. Brown & Co.	275 00	
George Collins	325 00	
Ralph Davis	150 00	
A. C. Evans & Co.	350 00	
Total as per General Ledger		1600 00

B. U. Bates

Schedule of Creditors' Balances, (Date)

A. C. Allan	260 00	
D. O. Bacon	140 00	
C. C. Cameron	350 00	
Total as per General Ledger		750 00

Other Types of Subsidiary Ledgers. — While customers' and creditors' accounts are the groups most generally transferred to special ledgers because of the large number of such accounts, in large businesses other groups of ac-

counts may be handled in the same manner. An *Expense Ledger* may be used for detailed expense accounts, a single account called *General Expense* or *Expense Ledger* being inserted in the General Ledger to represent this group.

It is also thought advisable in some instances to keep details concerning certain accounts private or confidential. In such cases a special ledger known as a *Private Ledger* is used and an account is inserted in the General Ledger known as Private Ledger account to represent or control this group of accounts. This ledger usually contains accounts that have to do with profits, capitalization, etc., and is kept by the proprietor, manager or someone in whom the management places confidence. A *Private Journal* is usually kept in connection with these accounts. Usually these private books are provided with some kind of a lock so their contents will not become public.

In the same manner any group of accounts may be transferred to a special ledger, if it seems desirable to do so, as long as a summary or controlling account is placed in the General Ledger to take their place and thus keep that ledger in balance.

Form and Use of General and Subsidiary Ledgers. — As to rulings, ledgers may be classified as *standard* ruling and *balance* ruling. The standard ruling is the form heretofore used, the debit side being an exact duplicate of the credit side. The balance ruling contains an extra column for the balances of the account as shown in the following illustration:

John Mattison,
145 Jackson Street, City.

Rating A-1

Date		Explanation	Fo.	Debit	Credit	Balance
19--						
May	1	2/10, n/30	S87	14 18		14 18
	9	" "	S96	87 10		101 28
	25	Cash	C17		75 00	26 28

Illustration — A Balance Ledger

The advantage of this form of ledger over the standard ruling consists in the recording of the balance, as well as the debit or credit. The balance may be entered at the time of each posting, or at the end of a month or business period.

As to mechanical make-up of ledgers, they may be classified as bound-leaf, loose-leaf, or card ledgers. Bound-leaf ledgers are usually used for permanent records; hence the General Ledger is usually a bound-leaf ledger. Loose-leaf ledger sheets are locked together in a binder, while card ledgers are usually filed in cabinets. Due to their ease in handling and distributing, loose-leaf or card ledgers are often used when subsidiary ledgers are desired. As to ruling, they are frequently of the balance type, while the bound-leaf is standard ruling.

EXERCISE 1-a

The ledger of Douglas & Co. contains the following customers' accounts: Crosby & Co., $178; Frank Banes, $375; Baker Brothers, $275; George Dyer, $156; Hovey & Co., $674. It also contains the following accounts with creditors: Atwood & Co., $820; C. F. Bates, $460; James Sharp, $637. They desire to change their books to a controlling account basis by transferring customers' and creditors' accounts to subsidiary ledgers but desire to continue to use their present ledger for all other accounts.
Required:

(*a*) Explain how to change the above accounts to a controlling account basis.
(*b*) Make journal entries to adjust the present ledger and open subsidiary ledgers.
(*c*) What titles are given to the various ledgers after making the change?

EXERCISE 1-b

Charles W. Burns wishes his accounts with customers and creditors transferred from his general ledger to the subsidiary ledgers. His trial balance, April 30, 19—, is:

Store Fixtures	$ 2,500	
Office Equipment	600	
Cash	15,400	
Notes Receivable	5,500	
M. E. Oakes	1,250	
George Shepherd	1,540	
Albert Darney	860	
Walter Smith & Co.	960	
Merchandise Inventory	6,000	
Office Supplies on Hand	50	
Notes Payable		$ 7,520
Henry T. Loomis		1,450
Benson & Co.		1,240
S. E. Buell		800
Charles W. Burns, Capital		23,650
	$34,660	$34,660

Required:

(*a*) Open ledger accounts, five to a page, and insert above balances.

(*b*) Prepare the necessary journal entries which, when posted, will close out the personal accounts in the General Ledger and open, in their stead, the proper controlling accounts and subsidiary ledger accounts.

(*c*) Prepare a trial balance from the General Ledger; and schedules to prove the subsidiary ledgers with the balances of the controlling accounts in the General Ledger.

QUESTIONS FOR DISCUSSION

1. What are the chief advantages claimed for special Purchases, Sales, and Cash Journals?
2. What is meant by the General Journal and in what respect does it resemble the General Ledger?
3. What is a "subsidiary ledger?"
4. What are the advantages claimed for grouping customers' and creditors' accounts in separate ledgers?
5. Explain in detail the procedure required to change a ledger to a controlling account basis if the same General Ledger is to be continued.
6. How does the procedure differ if a new set of books is to be used?
7. Define a "controlling account."
8. Assuming that a firm has 30,000 accounts, how should they be handled in the ledger?
9. What is meant by a "private ledger"?
10. Explain how an Expense Ledger may be helpful.
11. Name groups of accounts other than those referred to in the text that might be placed in a special ledger.
12. How is a trial balance taken when subsidiary ledgers are used?
13. What other titles are sometimes given to the Accounts Receivable and Accounts Payable Ledgers?
14. What determines the number of ledgers that should be used in a given business?
15. When should a creditors' ledger be used? When should it not be used?
16. Are subsidiary ledgers in balance? Explain.
17. Is it always necessary to have subsidiary ledgers for both customers' and creditors' accounts? Explain.
18. What would be an appropriate title for the subsidiary ledger for debtors in the books of a college, a club, a physician, a lawyer, a bank, an insurance company, a large office building?

CHAPTER II

ACCOUNTS RECEIVABLE ACCOUNT IN THE JOURNALS

The Purpose and Function of the Account. — The Accounts Receivable account in the General Ledger is a controlling account, and shows in total the charges and credits to customers' accounts which appear in detail in the Accounts Receivable Ledger. The use of this account serves the following purposes:

(1) Makes it possible for more than one bookkeeper to be working on the ledger accounts at one time.

(2) Provides for a choice of different types of ledgers, such as card or loose-leaf ledgers for customers' accounts.

(3) Reduces the number of accounts in the General Ledger which, therefore, reduces the number of accounts required in preparing the trial balance and financial statements.

The various debits and credits to the Accounts Receivable account may be summarized as follows:

ACCOUNTS RECEIVABLE

Debit:	*Credit:*
For total charge sales for the month as shown by the footing of the Sales Journal at the end of the month.	1. For cash received from customers as shown by the total of the Accounts Receivable column in the Cash Receipts Journal at the end of the month. 2. Notes and time drafts received from customers as shown by the General Journal. 3. Allowances made to customers as shown by the General Journal.

The balance of this account is a debit and represents the total amount due from customers; it is an asset and is shown in the balance sheet under current assets as Accounts Receivable. When the controlling account is not used, this item in the balance sheet is found by adding the balances of all customers' accounts in the trial balance.

Operation of the Account in the Sales Journal. — Since totals only are posted to the Accounts Receivable account in the General Ledger, special columns, each containing items pertaining to transactions with customers, are used in the journals as far as possible. The following illustration shows transactions recorded in the Sales Journal. Since only sales to customers appear in this journal, the amount column operates as a special column and the total of this column is posted to the debit side of the Accounts Receivable account in the General Ledger.

2 SALES JOURNAL

Date	L. F.	Account Dr.	Address	Terms	Sales No.	Amount	Total
19--							
June 1	8	Amos Pitman	Trenton, N. J.	2/10 n/30	1	246 00	
2	8	T. M. James	Longhorne, Pa.	Note 10 da.	2	500 00	
10	8	Wilson & Co.	Yonkers, N. Y.	Cash and 30 da. note	3	560 50	
16	8	Geo. A. Smith	Elizabeth, N. J.	2/10 n/30	4	150 00	
25	8	T. M. James	Longhorne, Pa.	1/30 n/60	5	240 50	
30	8	Robert Mason	1012 Market St.	Net cash	6	363 00	
30	8	Amos Pitman	Trenton, N. J.	2/10 n/30	7	75 00	
30	12	Accounts Rec. Dr.					2135 00
	34	Sales Cr.					

Illustration — Sales Journal

An account is opened in the Accounts Receivable Ledger for each of the customers whose names appear in the Sales Journal shown above. Each item in the amount column is then posted to the *debit* of the corresponding customer's account. This posting is done daily. At the close of the month, the Sales Journal is footed and ruled, and the total is posted to the *debit* side of the Accounts Receivable account and the same amount to the credit side of Sales account in the General Ledger. This results in a double posting of the debit items. However, the equality of the debits and credits in the ledger and trial balance is not affected by this double posting, since *only the accounts in the General Ledger* are considered in taking the trial balance. When posted the foregoing items appear in the Accounts Receivable Ledger and General Ledger as follows:

ACCOUNTS RECEIVABLE LEDGER

T. M. James 8

19--													
June	2	Note 10 days	S2	500	00								
	25	1/30 n/60	S2	240	50								

Robert Mason 8

19--																	
June	30	Net Cash		S2		363	00										

Amos Pitman

19--																	
June	1	2/10 n/30		S2		246	00										
	30	2/10 n/30		S2		75	00										

Geo. A. Smith

19--																	
June	16	2/10 n/30		S2		150	00										

Wilson & Co.

19--																	
June	10	Cash and note		S2		560	50										

GENERAL LEDGER

Accounts Receivable 12

19--																	
June	30			S2	2	135	00										

Sales 34

								19--									
								June	30			S2	2	135	00		

After posting from the Sales Journal, the sum of the balances of the customers' accounts in the Accounts Receivable Ledger equals the balance of the Accounts Receivable account in the General Ledger. For this reason the General Ledger account is said to *control* the Accounts Receivable Ledger accounts.

Operation of the Account in the Cash Receipts Journal. — As this journal contains cash receipts other than those from customers, a special *Accounts Receivable column* is used to separate the receipts from customers from other receipts so as to make it possible to post the *total receipts from customers* to the credit side of the Accounts Receivable account in the General Ledger at the end of the month. Under this arrangement credits to customers' accounts appear in the Accounts Receivable column, and all other credits in the Sundry Credits column. During the month of June transactions were recorded in the Cash Receipts Journal as shown on the following page:

4 CASH RECEIPTS

Date	Account Cr.	Explanation	G. L. Fo.	Sundry Credits	A. R. Fo.	Acc'ts Rec. Cr.	Sales Dis. Dr.	Net Cash Rec'ts Dr.
19--								
June 1	Thomas M. Mack	Cap. Investment	30	2000 00				2000 00
10	Amos Pitman	Inv. 6/1 less 2%			8	246 00	4 92	241 08
12	Notes Receivable	James' note due	11	500 00				500 00
12	Wilson & Co.	Acct. inv 6/10			8	200 00		200 00
26	Geo. A. Smith	Inv. 6/16 less 2%			8	150 00	3 00	147 00
30	Robert Mason	Acct. inv. 6/30			8	250 00		250 00
30	Total Sundry Cr.		✓	2500 00				
30	Accounts Rec. Cr.		12			846 00		
30	Sales Discount Dr.		38				7 92	
30	Cash Dr.		10					3338 08

Illustration — Cash Receipts Journal

Each item in the Accounts Receivable column in the foregoing illustration is posted to the credit side of the customer's account in the Accounts Receivable Ledger. This posting is done during the month as the transactions take place. At the end of the month the total of the Accounts Receivable column, $846, is posted to the credit of the Accounts Receivable account in the General Ledger. In posting to a customer's account during the month care must be taken to see that the total amount of the bill, or the part of the bill paid, is credited to the customer and not the net amount of cash *received* from him. For instance in the second transaction $246 is posted to the credit of Amos Pitman's account and not $241.08, the amount of cash received from him. The other items are posted as usual: total sales discount, $7.92, to the debit side of Sales Discount account; total net cash receipts, $3,338.08, to the debit side of Cash account; and the credits in the Sundry Credits column to the accounts named, Thomas M. Mack, Capital, $2,000, and Notes Receivable, $500. The total of the Sundry Credits column is not posted, a check mark (✓) being inserted in the folio column opposite this item to indicate that it is not to be posted.

Operation of the Account in the General Journal. — During June other transactions with customers were entered in the General Journal as shown on the following page. As the General Journal contains all transactions not recorded in the *special* books of entry, it is advisable to have a special column for customers' accounts, if the number of transactions warrant it, so as to facilitate posting by having totals available.

In this exercise there are not enough items with customers to warrant using a special column with Accounts Receivable; therefore, the standard form of journal is used showing the name of the customer's account to which the item is to be posted in the subsidiary ledger and also the name of the controlling account to which the item is to be posted in the General Ledger.

GENERAL JOURNAL

June 2, 19-- 3

G.L. Fo.	A.R. Fo.				
11		Notes	Receivable	500 00	
12	8		Accounts Receivable-T. M. James		500 00
			Received his 10-day note dated to-day with interest at 6% in settlement of bill of June 2.		
			12		
34		Sales		10 50	
12	8		Accounts Receivable-Wilson & Co.		10 50
			Allowed credit for goods received in damaged condition.		
			15		
11		Notes	Receivable	350 00	
12	8		Accounts Receivable-Wilson & Co.		350 00
			Received their 30-day note dated June 10 in settlement of balance of bill of that date.		

The debits are posted to the accounts named in the General Ledger. The credits are posted twice in detail, each item being credited to the Accounts Receivable account in the General Ledger as well as to the individual accounts in the Accounts Receivable Ledger. The posting to each ledger should be indicated as shown above.

Operation of the Ledgers. — After posting the items from the Cash Receipts Journal and the General Journal illustrated on pages 13 and 14, the ledgers appear as follows:

ACCOUNTS RECEIVABLE LEDGER

T. M. James 8

19--						19--				
June	2	Note 10 days	S2	500	00	June	2	J3	500	00
June	25	1/30 n/60	S2	240	50					

Robert Mason

19--						19--				
June	30	Net Cash	S2	363	00	June	30	C4	250	00

Amos Pitman 8

19--							19--					
June	1	2/10 n/30	S2	246	00		June	10		C4	246	00
June	30	2/10 n/30	S2	75	00							

Geo. A. Smith

19--							19--					
June	16	2/10 n/30	S2	150	00		June	26		C4	150	00

Wilson & Co.

19--							19--					
June	10	Cash and note	S2	560	50		June	12		C4	200	00
								12		J3	10	50
								15		J3	350	00
				560	50						560	50

GENERAL LEDGER

Accounts Receivable 12

19--							19--					
June	30		S2	2135	00		June	2		J3	500	00
								12		J3	10	50
								15		J3	350	00
								30		C4	846	00

Sales 34

19--							19--					
June	12	Returned	J3	10	50		June	30		S2	2135	00

Cash 10

19--												
June	30		C4	3338	08							

Notes Receivable 11

19--							19--					
June	2		J3	500	00		June	12		C4	500	00
June	15		J3	350	00							

Thos. M. Mack, Capital 30

							19--					
							June	1		C4	2000	00

Sales Discount 38

| 19-- | | |

8 Sold to Edward R. Pitts, Manchester, N. H., goods amounting to $775.90, terms net 10 days.

10 Sold bill of goods valued at $995.50 to R. G. Mann, Albany, N. Y., terms 2/10 n/30.

12 Sold to George Wilson, Springfield, Mass., merchandise valued at $960.55, terms 2/10 n/30.

15 Sold Barry Brothers, Wilkes Barre, Pa., bill of goods amounting to $250, terms 1/10 n/30.

18 Sold merchandise to value of $695.50 to R. G. Wells, Boston, Mass., terms cash 10 days.

22 Sold bill of goods amounting to $240 to R. G. Mann, Albany, N. Y., terms 2/10 n/30.

23 Sold merchandise valued at $1,250 to C. J. Underhill Co., Malden, Mass., terms 60-day note with interest.

27 Sold to C. J. Underhill Co., Malden, Mass., merchandise valued at $125, terms 2/10 n/30.

30 Sold Curtis & Son, Troy, N. Y., merchandise to the value of $129.75, terms 1/10 n/30.

Required:

(*a*) Foot and rule the Sales Journal and post the entries to an Accounts Receivable Ledger and a General Ledger.

(*b*) Prepare a schedule of the customers' balances from the Accounts Receivable Ledger.

(*c*) Prepare a trial balance from the General Ledger.

EXERCISE 2-b

Record the following transactions, in connection with data in 2-a, in a standard two-column journal as shown on page 14 and a Cash Receipts Journal having columns as follows: Sundry Credits, Accounts Receivable Cr., Sales Discount Dr., and Net Cash Receipts Dr.

June 19—

1 George S. Knapp has invested cash, $4,000.

6 Herman Black has returned to us merchandise valued at $225.

10 Received from Herman Black check for $750 to apply on bill of June 1, 2% discount to be allowed on the amount of the bill covered by the check.

11 Received check from George Wilson in settlement of bill of June 1 less 2%.

12 Allowed R. G. Wells $75 on bill of June 3 on account of goods received in damaged condition.

13 Received check from R. G. Wells in settlement of his bill of June 3.

16 Received check from R. G. Mann in settlement of bill of June 6, less 2%.

18 Received from Edward R. Pitts his 30-day note dated to-day in settlement of bill of June 8.

20 Received check from R. G. Mann in settlement of bill of June 10, less 2%.
23 Received from C. J. Underhill Co. their 60-day note dated to-day with interest at 6% in settlement of bill of June 23.
25 Received Check from Barry Bros. in settlement of bill of June 15, less 1%.
26 R. G. Wells has sent a memorandum of freight bill for $25 on goods shipped F.O.B. destination, which he has paid. His account is credited with this amount.
28 Received from R. G. Wells check for $300 on account.
30 Received from George Wilson merchandise to the amount of $150 returned from shipment of June 23.
30 Received from Herman Black check to settle his account in full.
30 The bank has allowed $1.65 interest on our account for the month of June.

Required:

(*a*) Foot and rule the journals and post to the Accounts Receivable Ledger and General Ledger used in Exercise 2-a.

(*b*) Prepare a schedule of the balances of the customers' accounts from the Accounts Receivable Ledger.

(*c*) Prepare a trial balance from the General Ledger.

EXERCISE 2-c

The following items are found on the books of a firm:

(*a*) Accounts Receivable Ledger accounts: Allen Bennett, debit balance, $350; Paul Bates, debit balance, $450; Charles Cole, debit balance, $500.

(*b*) General Ledger account: Accounts Receivable, debit balance, $1,300.

(*c*) Sales for period: Allen Bennett, $200; Paul Bates, $400; Charles Cole, $200.

(*d*) Journal entry: Note received from Paul Bates on account, $500; from Allen Bennett, $250.

(*e*) Cash Book — Receipts: From Allen Bennett, $100; Charles Cole, $350; Paul Bates, $200.

Required:

Show ledger accounts as a result of posting the foregoing items and prove individual accounts with the Accounts Receivable controlling account.

EXERCISE 2-d

A summary of the Accounts Receivable Ledger, January 1, 19—, shows the following:

W. C. Morrow	debit balance	$250.00
Ernest Ewing	" "	420.75
E. E. Merville	" "	722.34
C. A. Balcomb	" "	164.42
T. E. Herrick	" "	522.39

The Sales Journal shows sales as follows:

January	5	Ernest Ewing	Terms 2/10 n/30	$210.00
	8	T. E. Herrick	" net cash	325.25
	10	E. E. Merville	" n/30	175.10
	12	C. A. Balcomb	" 2/10 n/30	452.50
	18	W. C. Morrow	" cash 10 days	89.25
	24	Ernest Ewing	" 2/10 n/30	150.00
	30	W. C. Morrow	" 2/10 n/30	325.87

The Cash Book shows receipts as follows:

January	1	T. E. Herrick	on account	$500.00
	12	C. A. Balcomb	January 1 balance, less 2% dis., $3.29	161.13
	15	Ernest Ewing	January 1 balance and bill of January 5, less 2% dis., $4.20	626.55
	18	W. C. Morrow	January 1 balance	250.00
	20	E. E. Merville	January 1 balance	722.34
	30	W. C. Morrow	bill of January 18 less credit	60.00

The General Journal shows notes received and credit for goods returned as follows:

January	10	Note at 30 days from T. E. Herrick	$200.00
	20	Goods returned by W. C. Morrow	29.25
	26	Goods returned by C. A. Balcomb	152.50
	30	Note at 60 days from W. C. Morrow	325.87

Required:

(*a*) Set up Accounts Receivable Ledger accounts with opening balances.

(*b*) Set up a Sales Journal, Cash Receipts Journal, and General Journal, and record the above transactions.

(*c*) Foot and rule all books and post items to Accounts Receivable Ledger accounts.

(*d*) Open an Accounts Receivable account as it would appear in the General Ledger with opening balance and post totals of all books.

(*e*) Prove controlling account in the General Ledger with individual accounts in Accounts Receivable Ledger.

EXERCISE 2-e

Enter the following transactions of E. B. Atwood in books of original entry using the forms illustrated in this chapter:

February	1	Sold on account, 10 days, to A. B. Parker, merchandise, $1,000.
	1	Sold on account, to C. B. Post, merchandise, $3,500.
	10	Received cash from A. B. Parker to apply on account, $500.
	14	Sold on account to R. Williams, merchandise, terms 2/10 n/30, $1,500.
	15	Received a note at 10 days with interest at 6% from C. B. Post, on account, $2,000.

February 25 Received a check in payment of C. B. Post's note and interest due to-day.

26 Received a check from R. Williams in payment of invoice for $1,500, less 2%.

27 A. B. Parker returned merchandise valued at $200 sold to him on the 1st instant.

27 Received a check from A. B. Parker in full of account, $300.

28 Sold on account to A. B. Parker merchandise, $500.

Required:

(*a*) Foot and rule the journals.

(*b*) Open necessary ledger accounts and complete the postings to the proper ledgers.

(*c*) Take a trial balance of the General Ledger and prove the Accounts Receivable controlling account.

EXERCISE 2-f

April 19—

1 Sold merchandise amounting to $900 to George Brown, Kansas City, Mo., terms 2/10 n/30.

2 Sold to E. F. Jones, Yonkers, N. Y., bill of goods amounting to $375, terms 15-day note.

2 Received from E. F. Jones his 15-day note dated to-day in settlement of bill of April 2.

3 Sold merchandise valued at $1,545.65 to Westcott Bros., Richmond, Va., terms 3/10 1/30.

6 Sold A. G. Comstock, Albany, N. Y., bill of goods amounting to $750, terms net 30 days.

7 Received from Westcott Bros. merchandise valued at $325 returned on account of error in filling order.

9 Sold to R. O. Brownlee, Schenectady, N. Y., merchandise valued at $490.50, terms net 30 days.

11 Received from George Brown check in settlement of bill of April 1, less 2%.

13 Received from Westcott Bros. check in settlement of bill of April 3, less 3% after deducting credit of April 7.

17 Received cash in settlement of E. F. Jones' note due to-day.

18 Sold to George Brown, Kansas City, Mo., merchandise valued at $545, terms 2/10 n/30.

22 Sold to Westcott Bros., Richmond, Va., bill of goods valued at $875, terms 3/10 1/30.

25 Sold bill of goods amounting to $240 to A. G. Comstock, Albany, N. Y., terms net 30 days.

28 Received check from George Brown in settlement of bill of April 18, less 2%.

30 Sold to George Brown merchandise to the amount of $1,275, terms 2/10 n/30.

Required:

(*a*) Enter the above transactions in books of original entry, foot and rule the books, and post items to proper ledger accounts.

(*b*) Take a trial balance of the General Ledger and prove the Accounts Receivable controlling account.

QUESTIONS FOR DISCUSSION

1. State the functions of the Accounts Receivable controlling account.
2. How does the Accounts Receivable *account* differ from the Accounts Receivable *ledger?*
3. Where should Accounts Receivable appear in the balance sheet?
4. Explain what is meant by "double posting."
5. What do you understand by a columnar book of entry and what is its purpose?
6. In what way does a columnar Cash Receipts Journal facilitate the use of the Accounts Receivable controlling account?
7. How are the ledger postings indicated in columnar books?
8. Does the use of the Accounts Receivable controlling account save posting?
9. How many postings are made to the General Ledger from an ordinary Sales Journal such as shown on page 11?
10. What is meant by 'proving' the Accounts Receivable balance as shown in the trial balance?
11. How are sales returns and allowances handled when a controlling account for Accounts Receivable is used?
12. What is the purpose of a schedule of customers' balances and how is it prepared?
13. What is meant by 'proving' the Cash Receipts Journal and how is it done?
14. Why is a check mark (✓) inserted in the folio column opposite "Total Sundry Cr." in the Cash Receipts Journal?
15. What different arrangement of the General Journal is recommended when a large number of transactions with customers is recorded therein?

CHAPTER III

ACCOUNTS PAYABLE ACCOUNT IN THE JOURNALS

The Purpose and Function of the Account. — The Accounts Payable account in the General Ledger is a controlling account and shows in total the debits and credits to creditors' accounts which appear in detail in the Accounts Payable Ledger. This account serves the same purpose for creditors' accounts as does the Accounts Receivable account for customers' accounts. The accounts with creditors are usually not so numerous as are those with customers. In some cases there are not enough creditors' accounts to warrant keeping a control account for the same. In such cases creditors' accounts are kept in the General Ledger. When the Accounts Payable controlling account is used, the debits and credits may be summarized as follows:

ACCOUNTS PAYABLE

Debit:	*Credit:*
1. For cash paid creditors as shown by the total of the Accounts Payable column in the Cash Payments Journal at the end of the month. 2. For notes and time drafts issued to creditors as shown by the General Journal. 3. For allowances made by creditors as shown by the General Journal.	For total charge purchases as shown by the footing of the Purchases Journal at the end of the month.

The balance of this account is a credit and represents the amount owing to creditors. This balance is a liability and is shown on the balance sheet under current liabilities as Accounts Payable. It should be supported by a detailed schedule of creditors' balances.

Operation of the Account in the Purchases Journal. — The journals are ruled with special columns in which to enter creditors' items, for the same reason that this procedure was necessary for customers' accounts. The same principles apply to creditors' accounts that apply to accounts with customers. Transactions with creditors are recorded in the Purchases Journal, on the Cash Payments side of the Cash Book, and in the General Journal.

The form of Purchases Journal illustrated below is for the purpose of recording purchases of merchandise only. The amount column, therefore, operates as a special column, the total of which is posted to the Accounts Payable controlling account at the end of the month.

6 **PURCHASES JOURNAL**

Date	L. F.	Account Cr.	Address	Terms	Inv. No.	Amount	Total
19--							
June 1	9	F. Sanford	Chicago, Ill.	2/10 n/30	1	820 00	
10	9	Albert Dion	Rochester, N. Y.	Note 30 days	2	1260 00	
15	9	C. B. Cook	Buffalo, N. Y.	1/10 n/30	3	875 00	
20	9	F. Sanford	Chicago, Ill.	2/10 n/30	4	1460 00	
26	9	Albert Dion	Rochester, N. Y.	Net	5	700 50	
30	9	G. Walton	Philadelphia, Pa.	3/10 1/30	6	1420 00	
30	32	Purchases Dr.					6535 50
	26	Accounts Pay. Cr.					

Illustration — Purchases Journal

An account is opened in the Accounts Payable Ledger for each of the four creditors whose names appear in the Purchases Journal shown above. Each item in the amount column is then posted to the *credit* of the corresponding creditor's account. At the end of the month the Purchases Journal is footed and ruled, and the total is posted to the debit side of the Purchases account in the General Ledger and the same amount is posted to the *credit* side of the Accounts Payable control account, thus keeping this ledger in balance. The credit items are thus posted twice. They are posted as a *total* to the credit side of the Accounts Payable account in the General Ledger while the details are posted to the credit of the several creditors' accounts in the Accounts Payable Ledger.

When posted the items in the Purchases Journal appear in the Accounts Payable and General Ledgers as follows:

ACCOUNTS PAYABLE LEDGER

E. B. Cook 9

19--						
June	15	1/10 n/30	P6	875	00	

Albert Dion

19--						
June	10	Note 30 days	P6	1260	00	
	26	Net	P6	700	50	

F. Sanford 9

19-- June	1	2/10 n/30	P6	820	00		
	20	2/10 n/30	P6	1460	00		

G. Walton

19-- June	30	3/10 1/30	P6	1420	00		

GENERAL LEDGER

Purchases 32

19-- June	30	P6	6535	50			

Accounts Payable 26

19-- June	30				P6	6535	50

After posting from the Purchases Journal, the sum of the credits appearing in the various creditors' accounts in the Accounts Payable Ledger equals the credit in the Accounts Payable account in the General Ledger. The equilibrium of the General Ledger is not disturbed, however, because a like amount is posted to the debit of Purchases account. The Accounts Payable account, therefore, controls or represents the Accounts Payable Ledger. In the above illustration it is quite obvious that the General Ledger is in balance without going through the formality of taking a trial balance.

Operation of the Account in the Cash Payments Journal. — As cash payments for various expenses, purchases of equipment, freight on merchandise purchased, etc., in addition to payments to creditors are recorded in the Cash Payments Journal, a special Accounts Payable column is used to separate the payments to creditors from the other payments. Payments to creditors are entered in the Accounts Payable column while all other payments are entered in the Sundry Debits column. The Accounts Payable column thus makes it possible to post the total payments to creditors to the debit of the Accounts Payable controlling account in the General Ledger at the end of the month. During the month of June, transactions were recorded in the Cash Payments Journal as shown on the following page:

CASH PAYMENTS 5

Date	Account Dr.	Explanation	G. L. Fo.	Sundry Debits	A. P. Fo.	Acc'ts Pay. Dr.	Pur. Dis. Cr.	Net Cash Pay'ts Cr.
19--								
June 1	Office Equipment	Desk, typewriter, etc.	15	250 00				250 00
1	General Expense	Office supplies	36	26 50				26 50
1	General Expense	Rent for June	36	75 00				75 00
10	F. Sanford	Invoice 6/1 less 2%			9	800 00	16 00	784 00
12	Insurance Prepaid	Stock and fixtures	20	50 00				50 00
15	Office Salaries	From June 1-15	37	150 00				150 00
25	E. B. Cook	Invoice 6/15 less 1%			9	875 00	8 75	866 25
26	Purchases	Paid freight bills	32	94 10				94 10
30	Albert Dion	To apply on account			9	300 00		300 00
30	Office Salaries	From June 15-30	37	175 00				175 00
30	Sundry Debits		✓	820 60				
30	Accounts Payable	Dr.	26			1975 00		
30	Purchases Discount	Cr.	40				24 75	
30	Cash	Cr.	10					2770 85

Illustration — Cash Payments Journal

Each amount in the Accounts Payable column in the foregoing illustration is posted to the debit side of the respective creditor's account in the Accounts Payable Ledger. These items are posted from day to day as the transactions take place. At the end of the month the columns are footed and the total of the Accounts Payable column, $1,975, is posted to the debit of the Accounts Payable account in the General Ledger. The total of purchases discounts, $24.75, is posted to the credit side of the Purchases Discount account, and total cash payments, $2,770.85, to the credit side of the Cash account in the General Ledger. The total of the Sundry Debits column is not posted; the details in that column are posted to the debit side of their respective accounts in the General Ledger. A check mark (✓) is inserted in the folio column opposite the total Sundry Debits to indicate that it is not to be posted. The details in the Sundry Debits column are posted to the debit side of the various accounts named in the General Ledger while the details of the Accounts Payable column are posted to the debit of the various creditors' accounts in the Accounts Payable Ledger.

Operation of the Account in the General Journal. — When a special column is not provided for creditors' accounts in the General Journal, it is necessary to name the account in the General Ledger to which each item is to be posted as well as the account in the Accounts Payable Ledger. Transactions affecting creditors' accounts, and for which special journals are not provided, are recorded in the General Journal as illustrated on page 26.

Each item affecting a creditor's account is posted twice; once to the detailed creditor's account in the subsidiary ledger and again to the controlling account in the General Ledger.

Thus, in the following illustration the first item of $20 is posted to the debit side of Accounts Payable account in the General Ledger, and also to the debit side of F. Sanford's account in the Accounts Payable Ledger. The ledger folios are inserted as indicated for both ledgers.

GENERAL JOURNAL

June 5, 19-- 7

G.L. Fo.	A.P. Fo.				
26	9	Accounts Payable--F. Sanford	20 00		
32		Purchases		20 00	
		Allowances for shortage on invoice of June 1			
		10			
26	9	Accounts Payable--Albert Dion	1260 00		
25		Notes Payable		1260 00	
		Issued 30-day note in settlement of invoice of June 10			
		10			
16		Delivery Equipment	1500 00		
26	9	Accounts Payable--Auto Sales Co.		1500 00	
		Bought delivery truck			
		25			
26	9	Accounts Payable--F. Sanford	260 00		
32		Purchases		260 00	
		Returned goods on account of poor quality			

Operation of the Ledgers. — After posting the items shown in the Cash Payments Journal on page 25 and the General Journal in the foregoing illustration, the accounts affected appear in the Accounts Payable and General Ledgers as follows:

ACCOUNTS PAYABLE LEDGER

Auto Sales Co. 9

				19--					
				June	10		J7	1500	00

E. B. Cook 9

19--						19--					
June	25		C5	875	00	June	15	1/10 n/30	P6	875	00

Albert Dion

19--						19--					
June	10		J7	1260	00	June	10	Note 30 days	P6	1260	00
	30		C5	300	00		26	Net	P6	700	50

F. Sanford

19--						19--					
June	5	Allowance	J7	20	00	June	1	2/10 n/30	P6	820	00
	10		C5	800	00		20	2/10 n/30	P6	1460	00
	25	Return	J7	260	00						

G. Walton

						19--					
						June	30	3/10 1/30	P6	1420	00

GENERAL LEDGER

Purchases 32

19--						19--					
June	26		C5	94	10	June	5	Allowance	J7	20	00
	30		P6	6535	50		25	Return	J7	260	00

Accounts Payable 26

19--						19--					
June	5		J7	20	00	June	10		J7	1500	00
	10		J7	1260	00		30		P6	6535	50
	25		J7	260	00						
	30		C5	1975	00						

Notes Payable 25

						19--					
						June	10		J7	1260	00

Cash 10

19--						19--					
June	30		C4	3338	08	June	30		C5	2770	85

Office Equipment 15

19--																	
June	1			C5	250	00											

Delivery Equipment 16

19--																	
June	10			J7	1500	00											

Insurance Prepaid 20

19--																	
June	12			C5	50	00											

General Expense 36

19--																	
June	1			C5	26	50											
	1			C5	75	00											

Office Salaries 37

19--																	
June	15			C5	150	00											
	30			C5	175	00											

Purchases Discount 40

							19--										
							June	30				C5		24	75		

The balance of the Accounts Payable controlling account in the General Ledger shows $4,520.50, which agrees with a list of the creditors' balances as shown in the subsidiary ledger as follows:

Thomas M. Mack

Schedule of Creditors' Balances June 30, 19--

		Auto Sales Co.						1500	00								
		Albert Dion						400	50								
		F. Sanford						1200	00								
		G. Walton						1420	00								
		Total as per General Ledger												4520	50		

All postings to accounts in the Accounts Payable Ledger also appear in the Accounts Payable controlling account in the General Ledger. The items from the Purchases Journal and Cash Payments Journal are posted as totals, while the items from the General Journal are posted in detail due to the fact that special columns are not used. Attention is called to the fact that every value debited or credited to a creditor's personal account is also debited or credited to the Accounts Payable controlling account either as a separate item or through a total.

A trial balance now taken from the General Ledger on pages 15, 16, 27 and 28 shows the following results:

Thomas M. Mack

Trial Balance, June 30, 19--

	Cash	567 23	
*	Accounts Receivable	428 50	
	Notes Receivable	350 00	
	Office Equipment	250 00	
	Delivery Equipment	1500 00	
	Insurance Prepaid	50 00	
**	Accounts Payable		4520 50
	Notes Payable		1260 00
	Thos. M. Mack, Capital		2000 00
	Purchases	6349 60	
	Sales		2124 50
	General Expense	101 50	
	Office Salaries	325 00	
	Sales Discount	7 92	
	Purchases Discount		24 75
		9929 75	9929 75

* *Accounts Receivable Ledger control:* This agrees with the schedule of customers' accounts as shown on page 16.

** *Accounts Payable Ledger control:* This agrees with the schedule of creditors' accounts as shown on page 28.

The item, Accounts Payable, appears in the balance sheet under current liabilities as usual. Heretofore, the amount due creditors as shown in the balance sheet has been found by adding the creditors' balances in the trial balance. In the trial balance above, the amount due creditors is shown as a single amount and is taken from the Accounts Payable controlling account in the General Ledger.

EXERCISE 3-a

Record the following transactions using a Purchases Journal similar in form to that shown on page 23.

June 19—

1 Bought goods valued at $925 from A. B. Coughlin, Worcester, Mass., terms net 30 days.

2 Bought from Wright & Son, Cleveland, Ohio, merchandise to the value of $479.50, terms 2/10 n/30.

4 Bought from A. A. Wood, Chicago, Ill., bill of goods amounting to $250, terms 2/10 n/30.

10 Bought goods valued at $1,075 from K. D. Browne, Portland, Me., terms 60-day note with interest.

15 Bought merchandise valued at $176.75 from Wright & Son, Cleveland, Ohio, terms 2/10 n/30.

20 Bought from A. B. Coughlin, Worcester, Mass., bill of goods amounting to $348.25, terms net 30 days.

22 Bought from John J. Robinson, Providence, R. I., merchandise to the value of $775, terms net 30 days.

25 Bought bill of goods amounting to $250 from K. D. Browne, Portland, Me., terms 2/10 n/30.

Required:

(*a*) Foot and rule the Purchases Journal and indicate posting.

(*b*) Post the entries to an Accounts Payable Ledger and a General Ledger, using the same General Ledger called for in solutions to Exercises 2-a and 2-b in Chapter II.

(*c*) Prepare a schedule of the creditors' balances from the Accounts Payable Ledger, and prove with the Accounts Payable account in the General Ledger.

EXERCISE 3-b

Record the following transactions, in connection with data in Exercise 3-a, in a standard two-column journal such as shown on page 26 and in a Cash Payments Journal having columns as follows: Sundry Debits, Accounts Payable Dr., Purchases Discount Cr., and Net Cash Payments Cr.

June 19—

1 Paid rent of office for month of June, $100.

6 Returned to Wright & Son merchandise on bill of June 2 amounting to $75 which was damaged in transit.

10 Gave K. D. Browne our 60-day note dated to-day with interest at 6% in payment of his invoice of June 10.

12 Paid Wright & Son for invoice of June 2, less 2% after deducting merchandise returned June 6.

14 Paid A. A. Wood for invoice of June 4, less 2%.
15 Paid salaries from June 1–15 amounting to $175.
18 A. B. Coughlin has allowed us $250 on goods billed June 1 and received in a damaged condition.
20 Paid freight bills amounting to $32 on purchases.
25 Paid Wright & Son for invoice of June 15, less 2%.
27 Paid miscellaneous expense bills as follows: office supplies, $50; repairs to typewriter, $2.50; telephone, $6.35; electric light, $4.25.
28 Sent A. B. Coughlin check for $500 to apply on account.
30 Paid salaries from June 15–30, amounting to $175.

Required:

(*a*) Foot and rule the Cash Payments Journal.

(*b*) Post both journals to the Accounts Payable Ledger and General Ledger used in Exercise 3-a.

(*c*) Prepare a schedule of the balances of the creditors' accounts from the Accounts Payable Ledger.

(*d*) Prepare a trial balance from the General Ledger.

EXERCISE 3-c

A summary of the Accounts Payable Ledger January 1, 19— shows the following:

A. F. Johnson	credit balance	$250.50
R. L. Martin	" "	460.80
M. J. Thompson	" "	575.00
C. C. Winship	" "	210.00
W. A. Young	" "	370.75

The Purchases Journal shows purchases as follows:

January	1	R. L. Martin	2/10 n/30	$400.00
	2	C. C. Winship	Net 10 days	335.00
	6	A. F. Johnson	Note 60 days	525.00
	12	W. A. Young	n/30	375.00
	18	C. C. Winship	Net 10 days	150.00
	20	M. J. Thompson	Net 10 days	253.50

The Cash Book shows payments as follows:

January	5	W. A. Young	Balance due January 1	$370.75
	6	C. C. Winship	Balance January 1 less 2% dis. $4.20	205.80
	10	M. J. Thompson	On account	250.00
	11	R. L. Martin	Bill January 1 less 2% dis. $8.00	392.00
	15	A. F. Johnson	On account	200.00

The General Journal shows notes given and goods returned as follows:

January	6	Note at 60 days given to A. F. Johnson	$525.00
	10	Note at 30 days given to M. J. Thompson	575.00

January 15	Goods returned to C. C. Winship	$100.00
25	Goods returned to W. A. Young	275.75

Required:

(*a*) Set up Accounts Payable Ledger accounts with opening balances.

(*b*) Set up a Purchases Journal, Cash Payments Journal and General Journal, and record entries.

(*c*) Close all books and post items to Accounts Payable Ledger accounts.

(*d*) Open an Accounts Payable account in the General Ledger with opening balance and post totals of all books.

(*e*) Prove controlling account in the General Ledger with individual accounts in the Accounts Payable Ledger.

EXERCISE 3-d

Record the following transactions, making use of a Purchases Journal, Sales Journal, Cash Receipts Journal and Cash Payments Journal. Use columns in Cash Journals as follows:

Cash Receipts: Sundry Credits, Accounts Receivable Cr., Sales Discount Dr., and Net Cash Receipts Dr.

Cash Payments: Sundry Debits, Accounts Payable Dr., Purchases Discount Cr., and Net Cash Payments Cr.

June 19—

1 Ralph Power began business with a cash investment of $10,000.

1 Bought merchandise amounting to $1,800 from E. D. Green & Co., Boston; terms, cash, less 3%.

2 Sold merchandise for $500 to C. W. Morris, Albany; terms, 2/10 n/30. Bought merchandise for $720 from J. A. Carpenter, Rochester, New York; terms, net 30 days.

Paid cash for rent, $100; office supplies, $50; typewriter, $110; office furniture, $225.

5 Sold merchandise for $850 to A. B. Bennett, Columbus, Ohio; terms, cash, less 2%.

Bought merchandise from George Irwin, City, $820 on account.

Paid freight bills on purchases in cash, $62.50.

8 Received check from A. B. Bennett for bill of the 5th, less 2%.

Bought merchandise from S. Brown Co., New York, for $1,260; terms, 2/10 n/30.

10 Paid E. D. Green & Co. account, less 3%.

12 Received check from C. W. Morris for bill of June 2, less 2%.

15 Sent check to George Irwin for $500 to apply on account.

Sold C. W. Morris merchandise for $420; terms, net 30 days.

18 Sent S. Brown & Co. check for bill of the 8th, less 2%.

20 Received check for $150 from C. W. Morris to apply on account of bill of the 15th.

Bought of Atwood & Co., Chicago, Ill., goods valued at $975, on account, and of J. A. Carpenter, goods amounting to $1,500; terms, net 30 days.

25 Sold goods for $1,200 to E. B. Brown, Harrisburg; terms, cash $200, balance net 30 days.

Bought merchandise of C. T. Sharpe, St. Louis, Mo., valued at $420; terms, 2/10 n/30.

30 Sold goods for $126 to A. B. Bennett; terms, on account.

Sold goods for $625 to George Rodgers, Utica, N. Y.; terms, on account.

Paid salaries for the month, $475.

Required:

(*a*) Enter the transactions in books of original entry.

(*b*) Foot and rule the journals and post to the proper ledgers.

(*c*) Take a trial balance from the General Ledger.

(*d*) Prepare schedules of the customers' and creditors' balances from the subsidiary ledgers and prove with the controlling accounts in the General Ledger.

EXERCISE 3-e

Record the following transactions, making use of a set of books consisting of Sales Journal, Purchases Journal, Cash Book, General Journal, Accounts Receivable Ledger, Accounts Payable Ledger, and General Ledger. Use columns in the Cash Book as follows:

Cash Receipts: Net Cash Dr., Accounts Receivable Cr., and Sundry Credits.

Cash Payments: Net Cash Cr., Accounts Payable, Dr., and Sundry Debits.

January 19—

1 George Wilson began business investing cash, $8,000, and a note in his favor by Childs Bros. for $2,000.

4 Bought of G. Wallace merchandise, $1,750, on account.

6 Bought of B. Scanlon merchandise, $2,500, on account.

8 Gave G. Wallace cash, $500, and note at 30 days, in settlement of invoice of the 4th.

9 Sold Robert Grace merchandise, $300, on account.

10 Accepted B. Scanlon's draft at 20 days for $1,500.

14 Bought of G. Wallace merchandise, $800, and gave cash, $250, in part payment.

16 Received of Robert Grace cash, $150, to apply on account.

18 Gave B. Scanlon cash, $500, to apply on account.

20 Sold Walter James merchandise, $750, on account.

26 Paid rent, $125, in full for month.

27 Received of Walter James cash, $450, and his 30-day note for $250.

28 Sold Oscar Smith merchandise, $380, on account.

30 Paid acceptance from B. Scanlon, $1,500, due to-day.
31 Paid salaries in full to date, $250.
31 Sent credit memorandum to Oscar Smith for $80 covering claim for shortage.

Required:

(*a*) Foot and rule journals and indicate postings.
(*b*) Post and take a trial balance of the General Ledger.
(*c*) Prepare schedules from the subsidiary ledgers and prove controlling accounts.

QUESTIONS FOR DISCUSSION

1. State the functions of the Accounts Payable controlling account in the General Ledger, explaining for what it is debited and for what credited, where the postings to the account are taken from, and what the balance represents.

2. What is the advantage of using a Purchases Discount column in the Cash Payments Journal?

3. Explain how cash discounts are posted to the controlling accounts.

4. Prepare a ruling for a Purchases Journal, providing for distribution of purchases of merchandise to four classes of goods.

5. How are cash purchases of goods provided for in the journals?

6. Explain how the Purchases Journal may be arranged so as to record miscellaneous purchases other than merchandise, such as equipment, etc.

7. A bill of goods is purchased on account from George Styles, one of the regular customers of the business, whose account appears in the Accounts Receivable Ledger. How should this transaction be recorded?

8. A sight draft is drawn on a customer, James Merrill, for $1,000 in favor of a creditor, Albert Barnes. Merrill accepts the draft. How should this item be recorded in the controlling accounts?

9. A bookkeeper has made an error of $1,000 in footing his Purchases Journal. The correct footing should be $12,245 whereas he has posted to the General Ledger $13,245. His trial balance balances at the end of the month. How is this possible? What will disclose the $1,000 discrepancy?

10. Name a type of business where it would be inexpedient to operate an Accounts Payable controlling account.

11. Explain the method of checking or proving the balance of the Accounts Payable controlling account at the end of a fiscal period.

12. In what section and in what form does the Accounts Payable account appear in the financial statements? How does this differ from the method of showing creditors' accounts when the controlling account is not used?

CHAPTER IV

ADDITIONAL COLUMNS IN THE JOURNALS

Purpose of Special Columns in General Journal. — The principal function of a columnar journal of any kind is to reduce the number of items to be posted to the General Ledger. Where special journals are used there are often not enough items of the same kind to make it worth while to use special columns in the General Journal. When controlling accounts are used, however, it becomes necessary to post twice each item affecting the customer's or creditor's account, unless special columns are used for Accounts Receivable and Accounts Payable in the General Journal. This procedure was illustrated in previous chapters. Where notes are received and issued for merchandise and returns and allowances are recorded in the General Journal, it is much better to use a columnar journal. The simplest form of columnar journal is one having special columns for Accounts Payable Dr. and Accounts Receivable Cr. as shown in the illustration on the following page in which the transactions appearing in the journals illustrated on pages 14 and 26 are entered.

The method of footing and ruling the journal in the following illustration, preparatory to posting to the ledgers, is similar to that outlined for the special journals shown in Chapters II and III. The arrangement of the footings as shown in this illustration has the additional advantage of providing a convenient method of summarizing the debits and credits, for the purpose of proving that the journal is in balance before posting. The footing of the Accounts Payable Dr. column is extended to the Sundry Debits column and added thereto to find the total debits. The footing of the Accounts Receivable Cr. column is likewise extended to the Sundry Credits column and added thereto to find the total credits. The total of the Accounts Payable column is posted to the debit side of Accounts Payable account in the General Ledger, while the details of this column are posted to the debit side of the accounts of the creditors named in the Accounts Payable Ledger. The details of the Sundry Debits and Sundry Credits columns are posted to their respective accounts in the General Ledger. The totals of these columns are not posted, which fact is indicated by placing a check mark (✓) in the folio column. The total of the Accounts Receivable column is posted to the credit side of the Accounts Re-

GENERAL JOURNAL

June 2, 19--

Accounts Pay. Dr.	Sundry Debits	L. F.		Sundry Credits	Accounts Rec. Cr.
	500 00	11	Notes Receivable		
		8	T. M. James		500 00
			10-day note dated today with interest at 6% for bill June 2.		
			5		
20 00		9	F. Sanford		
		32	Purchases	20 00	
			Shortage, inv. June 1		
			10		
1260 00		9	Albert Dion		
		25	Notes Payable	1260 00	
			30-day note for invoice June 10.		
			10		
	1500 00	16	Delivery Equipment		
		26	Accounts Payable--		
		9	Auto Sales Co.	1500 00	
			Bought delivery truck		
			12		
	10 50	34	Sales		
		8	Wilson & Co.		10 50
			Allowance for goods received in damaged condition.		
			15		
	350 00	11	Notes Receivable		
		8	Wilson & Co.		350 00
			30-day note dated June 10 for balance of invoice of June 10.		
			25		
260 00		9	F. Sanford		
		32	Purchases	260 00	
			Goods returned on account of poor quality.		
	2360 50	✓	Sundry Debits		
1540 00	1540 00	26	Accounts Payable Dr.		
		✓	Sundry Credits	3040 00	
		12	Accounts Receivable Cr.	860 50	860 50
	3900 50			3900 50	

Illustration — Special Columns in General Journal

ceivable account in the General Ledger, while the details are posted to the credit side of the respective customers' accounts in the Accounts Receivable Ledger.

Additional Columns in the General Journal. — If there are a large number of notes received and issued, special columns may be added for Notes Receivable Dr. and Notes Payable Cr. The headings of the journal then appear as follows:

GENERAL JOURNAL

Notes Rec. Dr.	Accounts Payable Dr.	Sundry Debits	L. F.		Sundry Credits	Accounts Rec. Cr.	Notes Payable Cr.

Illustration — Six-Column General Journal

If the number of items warrant, special columns may be inserted for Sales Returns Dr. and Purchases Returns Cr., making four debit and four credit columns. It may be practical to add other columns for which there are at least five transactions during a month.

Columns are not commonly used for Accounts Receivable Dr. and Accounts Payable Cr., as such transactions are infrequent. When a transaction requires that a customer be debited or a creditor credited in the General Journal, the items are entered in the Sundry columns and posted twice as shown in the transaction crediting the Auto Sales Co. on June 10 in the columnar journal illustrated on page 36.

A journal arranged as in the foregoing illustrations, with the debit columns to the left and the credit columns to the right of the names of the accounts and explanations, is known as a "split" journal. All the amount columns may appear to the right of the names of the accounts and be arranged in any order desired.

Further Use of Columns in Cash Receipts and Cash Payments Journals. — Since the use of special columns, each intended to receive items of a specific type, saves much time in posting, this principle may be extended to other items in the cash journals in addition to those necessary for the successful operation of controlling accounts. When cash sales are frequent, a Cash Sales Cr. column is used in the Cash Receipts Journal. This not only saves posting but provides a means of classifying sales when a similar column is used in the Sales Journal as illustrated on page 38. Columns for General Expenses and Selling

CASH RECEIPTS

Date	L. F.	Account Cr.	Explanation	Sundry Credits	Accounts Receivable Cr.	Cash Sales Cr.	Sales Disc. Dr.	Net Cash Receipts Dr.
19--								
April 1	✓	Balance	In Bank $1,580.50					
1		Robert Ames	To apply on account		250 00			250 00
5		Notes Receivable	Rogers note due	420 00				420 00
5		Interest Income	30 da. on above 6%	2 10				2 10
5	✓	Cash Sales	To date			175 00		175 00
10		S. Walton	Inv. March 31, less 2%		375 00		7 50	367 50
12	✓	Cash Sales	To date			320 00		320 00
15		W. S. Jones	Inv. April 1, less 2%		440 00		8 80	431 20
15		Notes Receivable	Roberts note due	200 00				200 00
15	✓	Sundry Credits		622 10				
15		Accounts Receivable Cr.			1065 00			
15		Cash Sales Cr.				495 00		
15		Sales Discount Dr.					16 30	
15		Cash Dr.	Total Receipts					2165 80
15	✓	Balance	April 1, 19--					1580 50
								3746 30
April 16	✓	Balance	$383.12					

Illustration — Special Columns in Cash Receipts Journal

Expenses may be used in the Cash Payments Journal. A form of journal illustrating the use of these additional columns where cash receipts and cash payments are recorded in one book is shown above.

Cash Sales Column in the Sales Journal. — The following form of Sales Journal illustrates the use of a Cash Sales column:

SALES JOURNAL

Date	L. F.	Account Debited	Terms	Sale No.	Accounts Receivable Dr.	Cash Sales Dr.	Clothing Dept. Cr.	Shoes Dept. Cr.	Haberdashery Dept. Cr.
19--									
April 5		W. S. Jones	2/10 n/30	56	440 00		240 00	150 00	50 00
5	✓	Cash Sales				175 00	30 00	120 00	25 00
8		Bacon & Company	2/10 n/30	57	1500 00		700 00	400 00	400 00
10		Rice and Baker	Net	58	300 00		200 00		100 00
12	✓	Cash Sales				320 00	110 00	75 00	135 00
15		S. Walton	2/10 n/30	59	750 00		500 00	250 00	
15		Accounts Receivable Dr.			2990 00				
15		Cash Sales Dr.				495 00			
15		Clothing Sales Cr.					1780 00		
15		Shoes Sales Cr.						995 00	
15		Haberdashery Sales Cr.							710 00

Illustration — Cash Sales Column in Sales Journal

CASH PAYMENTS

Date	L. F.	Account Dr.	Explanation	Ck. No.	Sundry Debits	Accounts Payable Dr.	Gen'l Exp. Dr.	Selling Exp. Dr.	Pur. Disc. Cr.	Net Cash Payments Cr.
19--										
April 1	✓	General Expense	Rent of office	82			100 00			100 00
1	✓	Selling Expense	Rent of sales room	83				75 00		75 00
5		Geo. Wilson & Co.	Inv.March 26,less 2%	84		560 00			11 20	548 80
5	✓	General Expense	Office supplies	85			25 00			25 00
6		Office Equipment	Typewriter	86	105 00					105 00
8		Notes Payable	Discounted at Bank	87	800 00					800 00
8		Interest Expense	60 da. int. at 6%	87	8 00					8 00
10		C. T. Ward	Inv.March 31,less 1%	88		562 00			5 62	556 38
10	✓	Selling Expense	Advertising	89				60 00		60 00
12		T. W. Oakes & Co.	Inv. April 2,less 2%	90		750 00			15 00	735 00
15		Salaries and Wages	April 1 - 15	91	350 00					350 00
15	✓	Sundry Debits			1263 00					
15		Accounts Pay. Dr.				1872 00				
15		General Expense Dr.					125 00			
15		Selling Expense Dr.						135 00		
15		Purchases Disc. Cr.							31 82	
15		Cash Cr.	Total Payments							3363 18
15	✓	Balance	April 15, 19--							383 12
										3746 30

Illustration — Special Columns in Cash Payments Journal

The use of the Cash Sales column makes it possible to distribute both charge sales and cash sales to the proper departmental sales accounts. The total of the Cash Sales column in the Sales Journal is posted to the debit side of Cash Sales account in the General Ledger and cancels the credit to this account, posted from the Cash Receipts Journal. Its use in the Sales Journal makes it unnecessary to use columns for departmental sales accounts in the Cash Receipts Journal. The cash sales total may be checked in both the Cash Receipts Journal and the Sales Journal and not posted, thus dispensing with the use of Cash Sales account in the ledger. It is better, however, to show cash sales in a separate account in the ledger as well as include them in total Cash debit and Sales credit.

Importance of Proving Journals before Posting. — Only in the standard two column form of General Journal are postings indicated by position; in the special journals they are indicated by properly labeled columns. It is, therefore, important that each column be headed properly and that at the end of the month, after footing and proving the equality of the debit and credit columns, the totals be properly defined for posting purposes by writing on the same line with the amount the name of the General Ledger account to which the item is to be posted. As soon as the transactions for the month have been entered, the columns should be footed in small pencil figures and the sum of the footings of the debit columns compared with the sum of the footings of the credit columns. If they do not agree the error must be located before posting to the ledgers.

A form of summary for posting may be used for this purpose and copied at the end of each journal. This not only has the advantage of putting data in convenient form for posting but provides a proof of posting of the book at the same time. Under this plan the summary for the Cash Payments Journal shown on page 39 would appear as follows:

Summary for Posting April 15, 19--

	Debits	Credits
✓ Sundry Debits	$1263.00	
Accounts Payable	1872.00	
General Expense	125.00	
Selling Expense	135.00	
Purchases Discount		$ 31.82
Cash		3363.18
	$3395.00	$3395.00

When posting is done from the summary the total of the various columns in the journals may be shown on one line and labeled "Totals." The items in the Sundry Debits column are posted as usual and checked in the summary.

EXERCISE 4-a

Record the following transactions in a General Journal having columns as follows: Notes Receivable Dr., Accounts Payable Dr., Sundry Debits, Sundry Credits, Accounts Receivable Cr., and Notes Payable Cr.

June 19—

1 Received from George Brown a 30-day note, bearing interest at 6%, for $342.20 to apply on invoice of this date.

2 Issued a 60-day note in favor of Robert Mills for $500 to apply on account.

3 Allowed James Hammond $50 credit on bill of goods sold him June 1, on account of shortage.

4 Returned goods to Robert Oakes valued at $142.50 on account of inferior quality, and received credit.

5 Drew a 30-day trade acceptance on James Morrow for $250, which Mr. Morrow has accepted and returned.

6 Drew a 60-day draft on H. Thacker, a customer, in favor of B. Williams Co. for $850 to apply on their invoice of the 5th.

8 A note for $450 bearing interest at 5%, held against George Collins, is dishonored

by him and charged to his account together with protest fees amounting to $2.50. (Protest fees were charged to General Expense when paid.)

10 Accepted a 20-day draft drawn on us by Joseph French Co. for $1,000 in their favor for bill of goods received on June 5.

12 Transferred to George Adams the 30-day note received from George Brown on June 1, and received credit for the note and accrued interest to date.

15 Robert Wells transfers to us a 60-day note dated June 5, for $720, signed by Roger Jenkins. Wells is allowed credit for the note less discount at 6% for the unexpired time.

20 Received a 30-day note for $235 from James Morrow to apply on account.

30 The proprietors of the business are credited for their monthly salary; Alfred Lane, $300; and James Sterns, $450.

Required:

After recording the transactions, foot and rule the journal and indicate the postings to the General Ledger.

EXERCISE 4-b

Norman Abbott closed his books on June 30, 19— and prepared a balance sheet as follows:

Balance Sheet, June 30, 19—

Assets			Liabilities		
Cash		$1,265.20	Notes Payable		$ 185.00
Notes Receivable		500.00	Accounts Payable:		
Accounts Receivable:			John J. Griffin & Co.	$65.80	
W. J. Goff	$274.15		Johnson Bros.	36.20	
James T. Luff	194.60		W. C. Murphy	52.50	
T. D. Ewing	526.15	994.90	L. Harvey & Son	95.60	250.10
Office Equipment		175.00	Norman Abbott, Capital		2,500.00
		$2,935.10			$2,935.10

Make the necessary journal entries to change the books from a non-controlling basis to a controlling basis, setting up the controlling accounts and subsidiary ledgers with Accounts Receivable and Accounts Payable. The following transactions will be recorded in properly ruled Purchases, Sales, Cash Receipts, Cash Payments, and General Journals. Cash Receipts and Payments Journals should be so ruled that posting may be done with a minimum of labor.

July 19—

1 Bought merchandise on account from John J. Griffin & Co., $620.

2 Sold merchandise on account, terms 2/10 n/30, to James T. Luff, $420.50.

3 James T. Luff returns merchandise of poor quality and is credited with $34.
4 Sent check to John J. Griffin & Co. in payment of invoice of June 4 for $65.80, less 2% discount.
5 Received from T. D. Ewing a 30-day 6% interest-bearing note for $450, dated to-day, to apply on balance due July 1.
6 Sold merchandise to Charles Allen, $600; terms 2/10 n/30.
7 Bought merchandise on account from R. C. Williams Co., terms 1/30 n/60, $750.
8 Paid Johnson Bros. the balance due them, less 1%.
10 Received check for $300 from W. N. Morris in payment of his note due to-day.
11 Transferred the note received from T. D. Ewing on July 5 to the Auto Sales Co. at its face value in part payment of a delivery truck costing $950. Paid the balance by check.
12 Received check from James T. Luff for bill of July 2, less 2%.
15 Sent L. Harvey & Son a 30-day note dated January 10, for $95.60. Paid salaries, $150.
16 Received check from Charles Allen for bill of July 6, less 2%.
20 Sold merchandise to John Higgins on account, $172.80.
25 Bought merchandise from T. M. Hill, $1,200, terms 1/30 n/60.
28 Sold O. B. Saunders for cash, less 3%, goods valued at $650 and received his check.
31 Mr. Abbott withdrew cash, $75, and merchandise $60.

Required:

(*a*) Original journals, properly ruled.

(*b*) Post to the ledgers, prepare trial balance from General Ledger.

(*c*) Prepare schedules of the subsidiary ledgers and show proof of the controlling accounts.

EXERCISE 4-c

September 1, 19— Opened new books for George Gordon with the following balances: Sales Ledger — William Smith, $650; C. P. Wells, $695.87; Peter Dearborn, $350. Purchases Ledger — Willis & Cox, $280; Brown & Co., $280. Balance of cash on hand, $7,865.87. Merchandise Inventory, $5,600. Office Equipment, $392.90.
2 Paid rent of store, $80.
3 Received 30-day note from William Smith on account, $500. Sold merchandise to Miner & Son, terms 2/10 n/30, $700.
5 Bought merchandise from Rand Jobbing House, terms 3/10 n/30, $1,650. Received $200 from C. P. Wells on account.
7 Paid Brown & Co. $200 on account. Paid Willis & Cox $200 on account.
8 Bought from Anderson & Clark $1,500 worth of merchandise, terms 5/30 n/60. Received check in full of account from Peter Dearborn, less 2%.

9 Sold Williamson Co. $650 worth of merchandise, terms 2/10 n/30.
11 C. P. Wells paid balance of his account. Bought from Stewart & Son $650 worth of merchandise, terms 5/30 n/60.
12 Received check from Miner & Son to pay invoice of the third.
14 Issued 30-day note for $50 to Brown & Co. on account. Returned $50 worth of merchandise to Anderson & Clark, from purchase of the 8th. Paid salaries, $200.
15 Bought stationery for $24.56 cash.
Paid Rand Jobbing House bill of the 5th.
16 Sold old typewriter for $35.50 cash. (Credit Office Equipment.)
17 Sold Edson Bros. $121.34 worth of merchandise, receiving cash.
20 Paid balance due Brown & Co.
21 Received check from Williamson Co. for $365, no discount, to apply on our bill of the 9th.

Required:

(*a*) Record above data in journals as follows: General Journal using form on page 36, and Purchases, Sales, Cash Receipts and Cash Payments Journals as illustrated in Chapters II and III.

(*b*) Foot and rule journals and post to ledgers.

(*c*) Prepare trial balance from General Ledger.

(*d*) Prepare schedules from subsidiary ledgers and prove controlling accounts.

EXERCISE 4-d

Oct. 1, 19— Wm. French begins business investing cash, $2,500; merchandise, $2,875.90; office equipment, $589.75; a store building, $4,875. He owes Fred Smith $3,000 on a note.
2 He sells Walter Dampman merchandise on account, $168.92, terms 2/10 n/30; also sells Thos. Lynch merchandise $175.82, terms 2/10 n/30.
3 He buys from Kimball Wholesale Co., Chicago, terms 1/30 n/60, merchandise $1,268.40; and sells Howard Roberts $18.75 worth of merchandise, receiving cash.
5 He sells L. Spaulding merchandise, terms 2/10 n/30, $175. He pays 30 days' interest at 6% on the note owed Fred Smith.
6 Cash sales, $75.95. He sells Hyman Maron $216.20 worth of merchandise, terms 2/10 n/30. He pays clerk hire $30.
8 He sells Paul Williams merchandise on account $350, terms net 30 days.
9 Paul Williams returns $40 worth of merchandise bought on the 8th and receives credit.
10 Walter Dampman sends check to pay bill of the 2d in full.
11 He sends a check to pay Kimball Wholesale Co. in full.
12 Thomas Lynch sends a check for $100 on account.

13 L. Spaulding sends check to pay bill of the 5th. He buys $762.50 worth of merchandise from Green & Co., N. Y. C., terms 30 days net. Pays clerk hire $30.

15 Paul Williams buys $450 worth of merchandise, terms 2/10 n/30. French returns $28.92 worth of merchandise bought from Green & Company on the 13th.

16 Sells George Fisher merchandise $162.95, terms 2/10 n/30.

17 Buys $795.46 worth of merchandise from Wanamaker & Son, Newton, Mass., terms 1/2 cash, 1/2 on 30-day note. Sends the cash and note.

18 Sells Raymond McClure merchandise $816.42, terms n/30.

19 Receives check from Paul Williams in settlement of bill of the 15th.

20 Sends Green & Co. a 30-day note for $500 on account.

21 Sells Wm. Hartman $189.62 worth of merchandise receiving in payment his 30-day note. Cash sales to date, $118.25. Pays clerk $30. Sells some office furniture for cash, $82.90. Raymond McClure returns $10.95 worth of merchandise bought on the 18th.

25 Buys for cash typewriter, $110.

30 Raymond McClure has accepted and returned our 30-day draft for $500 drawn in our favor.

Required:

(*a*) Record above data in journals as follows:

General Journal using form on page 37.

Purchases Journal using form on page 23.

Sales Journal with the following amount columns: Accounts Receivable Dr., Cash Sales Dr., and Total Sales Cr.

Cash Book with columns as follows:

Cash Receipts: Sundry Credits, Accounts Receivable Cr., Cash Sales Cr., Sales Discount Dr., and Net Cash Receipts Dr.

Cash Payments: Sundry Debits, Accounts Payable Dr., General Expense Dr., Purchases Discount Cr., and Net Cash Payments Cr.

(*b*) Foot and rule journals and post to ledgers.

(*c*) Prepare trial balance from General Ledger.

(*d*) Prepare schedules from subsidiary ledgers and prove controlling accounts.

EXERCISE 4-e

The following abstracts of the journals showing totals of the various columns together with analyses of the Sundry columns for the month ending June 30, 19—, are taken from the books of J. E. Davis who started business on June 1, 19—:

GENERAL JOURNAL

Notes Rec. Dr.	Accts. Pay. Dr.	Sundry Debits			Sundry Credits	Accts. Rec. Cr.	Notes Pay. Cr.
				1			
		900	00	Office Equipment			
				1			
		1,475	00	Delivery Equipment			
				1			
		13,127	45	Merchandise Inventory			
				10			
		1,875	00	Accounts Receivable			
				15			
		150	00	Loss on Delivery Equip.			
				25			
		2	50	Discount on Notes Receiv.			
				30			
		1	55	Collection and Exchange			
				10			
				Accounts Payable	1,400 00		
				15			
				J. E. Davis, Capital	18,000 00		
				15			
				Delivery Equipment	150 00		
				20			
				Purchase Returns	75 00		
				25			
				Notes Receivable	3,002 50		
4,170 00	4,503 00	17,531	50	Totals	22,627 50	1,150 00	2,427 00

PURCHASES JOURNAL

Accounts Pay. Cr.	Furniture Dr.	Carpets & Rugs Dr.
6,284.10	1,570.50	4,713.60

SALES JOURNAL

Accounts Rec. Dr.	Furniture Cr.	Carpets & Rugs Cr.
5,618.00	2,412.00	3,206.00

CASH RECEIPTS

Date	L. F.	Account Cr.		Net Cash Rec. Dr.		Sales Dis. Dr.		Accts. Rec. Cr.		Sundry Credits	
June 1		J. E. Davis, Capital								3,600	00
10		Notes Payable								500	00
15		Delivery Equipment								900	00
25		Notes Receivable								300	00
		Totals		10,488	70	84	20	5,272	90	5,300	00

CASH PAYMENTS

Date	L. F.	Account Dr.	Net Cash Pay. Cr.	Pur. Dis. Cr.	Accts. Pay. Dr.	General Exp. Dr.	Selling Exp. Dr.	Sundry Debits
June 1		Insurance Prepaid (1 yr.)						36 00
15		Delivery Equipment						1,500 00
20		J. E. Davis, Personal						75 00
25		Notes Payable						630 00
30		Freight In						225 00
		Totals	5,612 90	35 20	2,392 10	377 50	412 50	2,466 00

Schedules from the subsidiary ledgers show the following:

Accounts Receivable Ledger		Accounts Payable Ledger	
George Bowen	$ 136.20	White & Co.	$ 75.00
A. S. Ames	124.00	W. E. Fallon	110.00
James Craven	695.10	Theodore Oakes	604.00
W. E. Merriam	114.80	Total	$ 789.00
Total	$1,070.10		

Required:

(*a*) Prepare summaries for posting and prove that the various journals are in balance.

(*b*) Open accounts in the General Ledger, post the journals, take a trial balance and prove with schedules of the subsidiary ledgers.

(*c*) Prepare balance sheet and profit and loss statement, taking into consideration the following items:

Merchandise on hand:

	June 1	June 30
Furniture	$ 8,357.90	$ 8,244.50
Carpets and Rugs	4,769.55	8,095.50
Total	$13,127.45	$16,340.00

Stationery and supplies on hand, $86.20

Unexpired insurance for 11 months

Freight In charged one-third to Purchases — Furniture and the balance to Purchases — Carpets and Rugs

Purchase Returns credited to Purchases — Carpets and Rugs

Depreciation is not considered.

QUESTIONS FOR DISCUSSION

1. Name some of the advantages of using special columns in the General Journal.

2. (*a*) Why is it not customary to have special columns for Accounts Receivable Dr. and Accounts Payable Cr. in the General Journal?

(*b*) Name some transactions that would be entered in such columns when used.

3. Which side of the Cash Book usually has the greater number of special columns, the Cash Receipts or Cash Payments?

4. Explain why most of the columns in the Cash Receipts Journal are credits, while most of those in the Cash Payments Journal are debits.

5. How should the Sales and Purchases journals be arranged when it is desired to keep a record of merchandise by classes or departments as in a large retail drug business?

6. In Exercise 4-e there is an item Loss on Delivery Equipment, $150, in the General Journal; another crediting Delivery Equipment in the Cash Receipts Journal for $900; and another in the Cash Payments Journal debiting Delivery Equipment for $1,500. Outline the probable transactions that would result in such entries.

7. Explain how notes received and issued are handled when controlling accounts are kept with Accounts Receivable and Accounts Payable.

8. Outline the principal advantages claimed for the use of controlling accounts for customers' and creditors' accounts.

9. Name the chief advantages in using special columns in the various journals.

10. On June 6 a bill of goods is sold to George Cox, a customer, terms net cash, and his check is received the same day. What is the best method of recording this transaction assuming that controlling accounts are kept?

11. Explain how the use of a controlling account may be extended to include a Private Ledger.

12. George Browning, who has been using an ordinary two column Cash Book, has changed the handling of customers' and creditors' accounts in his books to a controlling account basis. What changes will be necessary in his Cash Book to take care of this properly?

13. In Chapters II and III separate Cash Receipts and Cash Payments journals are illustrated instead of the ordinary two-page Cash Book with receipts on the left and payments on the right page. State some of the advantages claimed for this method.

14. In concerns having controlling accounts for customers and creditors, what columns are desirable in the General Journal? Explain the method of posting the columns named.

15. What is the effect of the use of subsidiary ledgers for customers and creditors upon the trial balance?

SUMMARY OF CHAPTERS I–IV

The principle of classifying and segregating original entries of transactions of a similar nature and of frequent occurrence in special journals is extended to the ledger, accounts of a similar nature being recorded in special ledgers known as *subsidiary* ledgers. A separate ledger for customers' accounts is kept and is known as the Accounts Receivable Ledger. A separate ledger for creditors' accounts is also provided and is called the Accounts Payable Ledger. These special ledgers may be subdivided into sections if the number of accounts is large enough to warrant it.

The General Ledger reflects the condition of the business enterprise as a whole and contains all accounts except those with customers and creditors. In order to maintain the debit and credit balance, an account is inserted in the General Ledger to record the aggregate of all transactions with customers. This is known as the *Accounts Receivable* account. A similar account is used to show the total of all transactions with creditors. This is known as the *Accounts Payable* account. Since these accounts represent the detailed accounts in the subsidiary ledgers they are said to control these accounts and they are accordingly referred to as *controlling* accounts. The total of the detailed balances from the subsidiary ledger must be in agreement with the balance shown by the controlling account in the General Ledger. In order to prove that this is so at the time the trial balance is taken a schedule or list of the individual balances is made up, the total of which is compared with the amount shown in the controlling account in the General Ledger.

The principle of controlling accounts may be applied to any group of accounts which become numerous enough to warrant placing them in separate ledgers. In the same way accounts of a private nature may be transferred to a Private Ledger. In each case an account is inserted in the General Ledger to take the place of the accounts removed and this account must receive the aggregate of the postings to the subsidiary ledger. Details are posted to the accounts in the subsidiary ledgers in the same manner as if they were in the General Ledger. Double posting refers to posting in detail to the special ledgers and in total to the General Ledger.

In order to operate the controlling accounts with the least amount of labor each book of original entry must be of the columnar type having special columns for Accounts Receivable and Accounts Payable items so that the totals may be posted to the controlling accounts in the General Ledger. Various types of general journals may be used. If the items affecting the controlling accounts

are infrequent the standard two column journal is used and such items as affect personal accounts are posted in detail to both the general and the subsidiary ledgers.

The chief function of special columns in books of entry is to save posting, in whatever connection they are used. Both the general and special journals may, therefore, contain other special columns than those affecting customers' and creditors' accounts. Any column may be added for which there are enough transactions of a similar nature to warrant its use.

Controlling accounts relieve the General Ledger of detailed accounts, make it easier to take a trial balance and prepare statements promptly, permit of dividing up the ledger work among several bookkeepers so that posting of customers' and creditors' accounts may be kept up to date, make it easy to find total amount due from customers and owing to creditors at any time, assist in localizing errors so that the trial balance is not delayed, and make possible the use of loose-leaf or card ledgers for detailed accounts.

Columnar journals simplify the recording of transactions, save posting, reduce the possibility of errors, make it possible to record transactions with deductions, such as cash discounts, in one journal, and make possible the use of controlling accounts by enabling the posting of totals to the general ledger controls.

ADJUSTMENT OF ACCOUNTS

CHAPTER V

ADJUSTMENT OF FIXED ASSETS

Characteristics. — Fixed assets represent investments in property of a permanent nature, such as Land and Buildings, Office Equipment, Store Fixtures, Delivery Equipment, etc. These items are known as *tangible* fixed assets. All such assets purchased for use in the business, with the exception of land, are gradually consumed in the conduct of the business and become expenses. Therefore, before a correct balance sheet and profit and loss statement can be prepared it is necessary to make certain adjustments in the accounts.

There is another group of fixed assets known as *intangible* assets such as Goodwill, Patent Rights, etc., which will be discussed in subsequent chapters.

Depreciation and Obsolescence. — The decrease in the value of assets through wear and tear and the lapse of time is an expense to the business called *depreciation*. Another cause for the decreased value of certain assets is the invention of more improved equipment whereby the assets become out of date. New inventions have the effect of rendering valueless a number of machines each year. Sometimes older types of buildings, machines, etc., have to be discarded although they are as good as new. This decrease in the value of an asset on account of becoming obsolete is known as *obsolescence*.

While depreciation takes place from day to day, it is recorded only at the end of the year or other fiscal period. The amount of depreciation depends upon the nature of the asset and the conditions under which it is used. The most common method of calculating depreciation is known as the *straight line* method. Under this plan the asset is estimated to last a certain number of years, based on past experience, and the depreciation is distributed evenly over the years representing the life of the asset. The number of years divided into one hundred gives the rate per cent of depreciation to be written off each year. Thus, if the asset is estimated to last ten years, ten per cent of the cost is recorded each year as depreciation. Office equipment which costs $1,500 and

which is estimated to last ten years is depreciated on the books at the rate of 10% per year, or $150. The depreciation expense is charged to Depreciation account for that amount and is shown in the profit and loss statement as an operating expense.

Land and Buildings. — Although the assets, land and buildings, are frequently recorded in the ledger in one account called Real Estate, it is better practice to carry the cost of these assets in separate accounts. Buildings depreciate and in some cases become obsolete and have to be replaced, while land in many instances tends to increase in value due to increased demand for land as the country becomes more thickly settled. The expenses in connection with land and buildings differ also and require different treatment in the accounts.

Land Account. — When land is purchased, not only is the purchase price charged to the Land account, but also the cost of the agent's commission for buying, the attorney's fee for examining the title and looking after the legal phases of the transfer, and other expenses of a similar nature. Improvements to the land such as grading, sidewalks, etc., are charged to this account. Expenses such as taxes are charged to the Land account until the land becomes productive, after which time they are charged to the related expense account. For example, a tract of land is purchased for $9,500; $150 is paid an attorney for examining the title and for transfer charges; and $750 is paid a contractor for grading the land. After recording the above items, the Land account in the ledger appears as follows:

Land

19--																	
June	1	Purchase Price			9500	00											
	15	Legal Fees			150	00											
	30	Grading			750	00											

While land may increase or decrease in value due to demand for land in a particular locality, ordinarily no change is made on the books until the land is sold. When the land is actually disposed of, the Land account is credited for the total amount shown on the debit side of the account, thus closing the account. If the land is sold for more than cost, the excess is credited to a Profit on Sale of Land account. If it is sold for less than cost, the difference is charged to a Loss on Sale of Land account.

For example, assuming that the land in the foregoing illustration is sold for $12,000 cash, the entry to record the transaction is as follows:

Cash	$12,000.00	
Land		$10,400.00
Profit on Sale of Land		1,600.00

If it is sold for $10,000, the entry is as follows:

Cash	$10,000.00	
Loss on Sale of Land	400.00	
Land		$10,400.00

A separate account should be kept with each parcel of land. Any profit or loss on account of sale of land should not be carried directly to the Profit and Loss account in the ledger. The Profit and Loss account is not a current account, but is used only to summarize expenses and income at the close of the period.

The Profit on Sale of Land increases the net capital and appears in the profit and loss statement under "Other Income." Loss on Sale of Land decreases net capital and is shown in the profit and loss statement as "Other Expense."

Buildings Account. — When a building is acquired, the purchase price is charged to a Buildings account. All expenditures in connection with the acquisition of the building up to the time it is ready for use are also charged to this account. If the building is being erected, the contract price of the building and also the expenses for building permits, fees, etc., up to the time the property is ready for occupancy are charged to the Buildings account. After the building has been put into use, only those items are charged to the Buildings account that tend to prolong its life or increase its value. Ordinary repairs, taxes, insurance, etc., are charged to Buildings Expense and Income account. If a part of the building is rented to others, the amount received is credited to Buildings Expense and Income account. For example, a building is purchased for $25,000 and later an extension is added that costs $5,000; a new roof is put on the building at a cost of $2,000; painting and sundry repairs for the year amount to $500; taxes, $275; insurance, $55; and the upper floor is rented for $1,000. The building accounts affected by the foregoing transactions appear as follows:

Buildings

19--																	
Jan.	1	Cost			25000	00											
Feb.	10	Extension			5000	00											

Buildings Expense and Income

19--				19--			
Dec.	31	New Roof	2000 00	Dec.	31	Rental	1000 00
	31	Painting and Repairs	500 00				
	31	Taxes	275 00				
	31	Insurance	55 00				

At the end of the fiscal period the balance of the Buildings Expense and Income account shows the cost of maintaining the building. As it takes the place of rent and thus decreases net capital, it appears in the profit and loss statement as an operating expense. The Buildings account appears in the balance sheet as a fixed asset.

When property is purchased for investment purposes and not for the use of the business the balance of Buildings Expense and Income account usually shows a credit and represents the net income from the investment. As it increases net capital it appears in the profit and loss statement under "Other Income."

Depreciation Adjustment. — The difference between the cost of the asset as shown by the Buildings account and the amount of its depreciation to date as shown by its valuation reserve account is the present or *book value* of buildings. To record depreciation, Depreciation of Buildings account, or Buildings Expense and Income account, is debited and Reserve for Depreciation of Buildings account is credited. As depreciation represents that portion of the asset consumed in operating the business, it may be credited to the asset Buildings account. This plan is known as *writing down* the asset. However, for various accounting purposes it is better to carry the asset on the books at cost in the Buildings account and show the depreciation on the credit side of a Reserve for Depreciation of Buildings account. When the asset is disposed of, the total amount of its depreciation is transferred from the Reserve for Depreciation of Buildings account to the credit of the Buildings account. If the amount of depreciation has been estimated accurately, this transfer closes both accounts. Any difference represents over or under estimate and is transferred to the Capital account.

For example, the building in the foregoing Buildings account is estimated to have a life of thirty years; the annual depreciation is $3\frac{1}{3}\%$ or one-thirtieth of $30,000, or $1,000. The entry at the end of each year is as follows:

Depreciation of Buildings (or Buildings Expense and Income)	$1,000.00	
Reserve for Depreciation of Buildings		$1,000.00

The depreciation is shown in the profit and loss statement as an operating expense. The Reserve appears in the balance sheet as a deduction from the asset Buildings.

At the end of twenty-five years the building has become obsolete and is to be replaced by a modern building; $2,000 is received as salvage for the old building.

The ledger accounts before making the entries when the asset is disposed of are:

Buildings

19-- Dec.	31	Cost		30000	00						

Reserve for Depreciation of Buildings

						19-- Dec.	31	Depreciation		25000	00

The entries to record the disposition of the asset follow:

Reserve for Depreciation of Buildings	$25,000.00	
Buildings		$25,000.00
To transfer reserve to asset account.		
Cash	2,000.00	
Buildings		2,000.00
For sale of building material		
Loss on Sale of Buildings (Capital)	3,000.00	
Buildings		3,000.00

When the foregoing items are posted the building accounts appear as follows:

Buildings

19-- Dec.	31	Cost		30000	00	19-- Dec.	31	Cash		2000	00
							31	Res. for Dep.		25000	00
							31	Loss		3000	00
				30000	00					30000	00

Reserve for Depreciation of Buildings

19-- Dec.	31	To Building		25000	00	19-- Dec.	31	Depreciation		25000	00

The Loss on Sale of Buildings is handled the same as Loss on Sale of Land explained on page 52.

Revaluation Adjustments. — As a rule, increase in the value of an asset due to appreciation is not recorded on the books until the asset is disposed of. However, when a business that has been in existence for some time changes hands, or the owners sell an interest to a new partner, it sometimes becomes necessary to appraise and revalue certain assets. In this connection buildings are sometimes appraised at more than the book value. The excess in such cases is credited to the Capital account.

Assume that the Buildings account shows cost of building to be $20,000; that the Reserve account stands credited with $5,000; and that the present appraised value of the building is $18,000. The entry to adjust is as follows:

Reserve for Depreciation of Buildings	$5,000.00	
Buildings		$5,000.00
To transfer balance of reserve to asset account.		
Buildings	3,000.00	
Capital		3,000.00
To adjust Buildings account due to appreciation.		

If the buildings are appraised at less than book value, the difference is charged to Capital and credited to Buildings account.

EXERCISE 5-a

Land is purchased costing $5,000 and a building erected thereon at a cost of $20,000. Depreciation on the building has been figured for ten years at 3% per annum and credited to a Reserve account. The property is then sold for $24,000 cash, of which amount $16,000 is for the building and $8,000 for the land.

Required:

(*a*) Prepare entries to record the sale and adjust accounts.

(*b*) Set up T ledger accounts, insert balance of Land, Buildings, and Reserve for Depreciation accounts, post the above entries, and close all Land and Buildings accounts.

EXERCISE 5-b

On June 30, 19— George Wilson sold for $4,500 one of six vacant lots on Park Street which he had bought two years before. He paid $12.000 for the lots, $150 for taxes, and $450 for grading.

November 1, 19— he paid $50,000 to a contractor for erecting a building on four of the lots. (The building has an estimated life of thirty years with a salvage value of $5,000; therefore, $1,500 or $\frac{1}{30}$ of $45,000 will be charged to depreciation each year.)

December 15, 19— he paid $250 for painting building.

Required:

Prepare journal entries covering the above transactions and show balances of all Land and Buildings accounts affected as of December 31, 19— after allowing for depreciation for two months at the proper rate.

EXERCISE 5-c

January 1, 19—, five years later, the building and land occupied by the same, referred to in Exercise 5-b, are sold for $65,000, of which $50,000 is for the building and $15,000 for the land. Mr. Wilson takes a mortgage for $25,000 and receives cash for the balance.

Required:

Journal entries to record the sale and adjust the accounts on Mr. Wilson's books.

EXERCISE 5-d

June 19—

1 The Newton Realty Co. bought for $18,000 cash a store building located at 520 Washington Street. The building is valued at $15,000 and the land at $3,000.

10 Attorney fees and transfer charges amounting to $300 are paid in cash and prorated to land and building in proportion to cost.

30 Improvements and alterations to building amounting to $2,750 are paid in cash.

December 19—

31 Depreciation on building is provided for at the rate of 4% per annum. (Charge Depreciation of Store Building.)

This charge for depreciation is made at the end of each year at 4% per annum.

June 19—

1 Four years after the property was bought it is proposed to reorganize the firm and admit a new partner. In order to determine the proper valuation of the business all property is to be appraised. The appraisers fix the market value of the above property at $19,000, of which $4,000 is apportioned to the land and $15,000 to the building.

Required:

Prepare journal entries required to record all of the transactions and adjust the accounts.

EXERCISE 5-e

January 1, 19— T. B. Jordan buys as an investment the Keystone Building for $100,000. The seller takes back a purchase money mortgage for $50,000 at

6%; a second mortgage for $20,000 is placed at 8%; the balance of cost is paid in cash after adjusting prepaid insurance, $250, and taxes, $900, both for six months (credit Mr. Jordan's Capital account for the net cost of building paid by him in cash).

February 1 Received rentals from tenants $1,800; paid janitor's salary $125.

10 Paid for sundry repairs $125.

March 1 Received rents $1,740; paid janitor $125.

5 Paid for cleaning offices for new tenants $56; paid water rent to June 30, $150.

April 1 Received rentals $1,500; paid electric light bill for corridors, $26.80; paid janitor $125; paid interest on second mortgage; cost of running elevator (salaries and repairs) $325.

May 1 Received rentals $1,650; paid fuel bills, $980.

June 1 Received rentals $1,720; paid for repairs, $115; paid janitor for two months, $250; exits and fire escapes to comply with new fire ordinance, $800.

30 Received rentals $1,610; paid for electric light to date, $24.25; elevator service, $358; janitor, $125. Paid interest on first and second mortgages to date. Charge depreciation on building (value $80,000) at 3% per annum.

Required:

(*a*) Prepare journal entries for above transactions for six months ending June 30, 19—.

(*b*) Set up ledger accounts, post, take trial balance, and prepare a statement of income and expense showing net income from the investment and rate of return on the investment.

EXERCISE 5-f

January 1, 19—, P. B. Hayes purchased for cash a building lot on Bonwood Street costing $4,500, on which one year later he built a two-family house costing $16,000. During the year which elapsed before the house was completed, he paid taxes on the lot, $40; city street assessment, $124; miscellaneous expenses, $60. During the first year after completion the two apartments rented for $100 and $90 per month respectively. The maintenance charges during this year were insurance, $54; taxes, $346; repairs, $78; miscellaneous, $35; water rent, $48. Depreciation is considered on the basis of 3% of the cost of the house.

Required:

(*a*) Prepare journal entries for above transactions for two years ending December 31, 19—. (All transactions subsequent to the purchase of lot may be dated December 31, 19—.)

(*b*) Prepare a statement of income and expense showing net income from the investment and rate of return on the investment.

QUESTIONS FOR DISCUSSION

1. What is meant by the following terms as applied to fixed assets: (*a*) wasting, (*b*) tangible, (*c*) intangible, (*d*) book value?

2. In what way does depreciation differ from obsolescence?

3. What factors must be taken into consideration in figuring the rate of depreciation to be charged off each year?

4. Why should the value of land and buildings be charged to separate accounts in the ledger rather than to one account, such as Real Estate?

5. What two accounts should be kept with each piece of improved property owned? Why?

6. What type of expenditures on account of buildings are charged to Buildings account and what type to Buildings Expense account?

7. Name the items that are usually included as expenses resulting from the ownership of property.

8. An employer objects to charging taxes on vacant land to the Land account. He gives as his reason that paying taxes does not make the land worth more to him, and that, therefore, the value on the books should not be increased. Formulate a reply to his reasoning.

9. X claims that interest on a construction mortgage may be charged to the Buildings account, until the building is completed and ready for occupancy. State why he is, or is not, correct.

10. What is meant by "writing down" an asset and when is an asset usually "written down"?

11. What is meant by the term "appreciation"? What assets have a tendency to appreciate? Under what circumstances is an entry made for appreciation of an asset?

12. Where do profits or losses resulting from the sale of properties appear in the financial statements?

13. What adjustments of the accounts are necessary when an asset is sold?

14. Assuming that a factory was shut down for a period of six months due to lack of orders, is it proper, inasmuch as the building was not used, to omit a charge for depreciation during that time? Explain.

15. Mr. Bruce owns a tract of vacant land on Roosevelt Boulevard. He grants bill board privileges at an annual rental of $200 per front foot and leases the land from time to time for circus grounds, tourist camps, etc. To what account should the income received be credited?

CHAPTER VI

ADJUSTMENT OF FIXED ASSETS (CONTINUED)

Equipment. — Other fixed assets required by practically all business concerns for the successful operation of their business consist of equipment for use in the office, store, factory, and, in many cases, for delivery purposes. These items are usually classified as Office Equipment, Store Equipment, Machinery, and Delivery Equipment. An account is kept for each class in the General Ledger.

Office Equipment consists of desks, filing cabinets, safes, typewriters, calculating machines, etc.

Store Equipment consists of show cases, counters, shelves, scales, cash registers, trucks, etc.

Machinery includes all types of machines used in connection with the manufacture of goods. Inasmuch as this class of equipment is used only by manufacturing concerns a more complete study of the Machinery account will be taken up in connection with Manufacturing accounts.

Delivery Equipment consists of horses, wagons, auto trucks, etc.

The same adjustment principles apply to the foregoing items that apply to buildings. The specified asset account is charged with the cost of the equipment plus delivery and installation charges when the asset is acquired; it is credited for the cost price when sold or otherwise disposed of. The balance, therefore, always represents the cost price of the particular asset on hand. The upkeep or repairs to equipment, together with the cost of operating the same are charged to the related expense account. The balance of this account is shown in the profit and loss statement as an operating expense. These items all depreciate and tend to become obsolete, as do buildings, and, therefore, must be adjusted at the end of the fiscal period. All classes of equipment are sometimes entered under the account Equipment; but, since the rate of depreciation varies for different classes of equipment, it is better practice to keep a separate account for each class. Store and office equipment may be combined, but a better classification of expenses is secured if they are kept in separate accounts.

As with buildings, three accounts are kept with each group of assets — one, for the cost of the asset; another, for the reserve for depreciation; and a third,

for the repairs and operating cost. The latter is an expense account which may be combined with other expenses under the heading of General Administrative Expenses and Selling Expenses if so desired.

Depreciation Adjustment. — At the end of the fiscal period the related *expense* account is debited for the estimated depreciation and the related *reserve* account credited with an equal amount. Depreciation of office and store equipment is usually estimated at about 10% per annum, based upon an average life of ten years. Delivery equipment depreciates much more rapidly, the serviceable life of auto trucks being from four to five years or at the rate of depreciation of 20% to 25%. Horses and wagons last longer, the rate being from 10% to 12%. The expense account to be used depends on the wishes of the management with regard to expense classification. For example, office equipment on hand costs $1,200 and is estimated to last ten years. At the end of each year the following entry is made:

Depreciation of Office Equipment	$120.00	
Reserve for Depreciation of Office Equipment		$120.00
To record depreciation of office equipment on hand costing $1,200 at 10% per annum.		

Depreciation on all equipment is an operating expense. If a record of detailed expenses is not desired, depreciation is charged to General Administrative Expenses instead of to Depreciation of Office Equipment.

The entry for depreciation of store equipment is treated in a manner similar to that of depreciation of office equipment. For example, assuming that the cost of store equipment on hand, as shown by the ledger account, is $5,000 with an estimated life of ten years, the entry is as follows:

Depreciation of Store Equipment	$500.00	
Reserve for Depreciation of Store Equipment		$500.00
To record depreciation of store equipment on hand costing $5,000 at 10% per annum.		

If a related expense account is not kept, the foregoing depreciation is charged to Selling Expenses instead of to Depreciation of Store Equipment.

The depreciation adjustments for machinery and delivery equipment are handled in the same manner as is depreciation of store equipment. Depreciation of delivery equipment is a selling expense while depreciation of machinery is a factory expense, which is discussed in Chapter XXXII.

Replacements. — Except in the case of expensive pieces of machinery and equipment, it is not customary to keep a separate record of depreciation on

each equipment unit, but to base depreciation on the group as a whole. When an asset is removed from service the *reserve* account is charged with the *cost* value of the specific asset discarded less any amounts received if sold.

Illustration

(1) A safe costing $120 is sold at the end of the eighth year for $20. The entries at the time of sale are as follows:

Cash	$ 20.00	
Office Equipment		$ 20.00
Amount realized from sale of old safe.		
Reserve for Depreciation of Office Equipment	100.00	
Office Equipment		100.00
To charge reserve account with net cost of safe disposed of. Cost $120, less $20, sale value.		

(2) When equipment is disposed of during a fiscal period the depreciation of the asset disposed of should be calculated to the date of disposition and charged to the related expense account. If the above safe is disposed of in the middle of the year, the following entry, in addition to those shown above, is necessary:

Depreciation of Office Equipment	$6.00	
Reserve for Depreciation of Office Equipment		$6.00
To record depreciation on safe from beginning of fiscal period to date. $120 for 6 mos. at 10%.		

(3) If it is desired to record separately the amount reserved for each unit of equipment, at the end of eight years the Reserve for Depreciation of Office Equipment account contains $96 which has been reserved for this particular safe, in which case the entry for the sale of the old safe is the same as above, while the second entry to adjust the reserve and asset accounts is as follows:

Reserve for Depreciation of Office Equipment	$96.00	
Loss on Office Equipment	4.00	
Office Equipment		$100.00
To transfer to Office Equipment account amount reserved on safe disposed of and to adjust the asset account.		

Cost of safe		$120.00
Less-Depr. for 8 yrs. at 10%	$96.00	
Proceeds of sale	20.00	116.00
Loss		$ 4.00

The loss of $4 represents the variation in the depreciation estimate and should not be considered an operating expense for the current period, but shown in the profit and loss statement under Other Expenses, similar to loss on buildings described in the previous chapter. The apparent profit or loss due to over or under estimate of depreciation may be debited or credited to a Depreciation Adjustment account if desired, and closed directly into Capital account.

(4) If a new safe costing $150 is purchased to take the place of the one discarded, the entry is as follows:

Office Equipment	$150.00	
Cash or Accounts Payable		$150.00

Fire Loss Adjustment. — Equipment that is destroyed or damaged on account of fire or accident presents a little different problem on account of the insurance element involved. The insurance company usually settles on the basis of the value of the asset at the time of the fire. If depreciation has been accurately provided for, this value should agree closely with the book value of the asset which is found by deducting the amount of the *reserve* account from the *asset* account.

Illustration

On April 1, 19—, a garage was entirely destroyed by fire. The following accounts were on the books at the time of fire: Delivery Equipment, $7,500; Reserve for Depreciation of Delivery Equipment, $1,500. Depreciation has been figured at 20% per annum up to December 31 of the preceding year. Unexpired insurance contains an item of $192 applicable to delivery equipment which expires December 31. The insurance company settled for $5,400. The entries to adjust the accounts with delivery equipment are as follows:

Depreciation of Delivery Equipment	$ 375.00	
Reserve for Depreciation of Delivery Equipment		$ 375.00
To record depreciation of delivery equipment from January 1 to April 1.		
Reserve for Depreciation of Delivery Equipment	1,875.00	
Delivery Equipment		1,875.00
To close reserve into asset account.		
Fire Loss Adjustment	5,625.00	
Delivery Equipment		5,625.00
To close book value of Delivery Equipment asset account to Fire Loss account.		

Insurance Expense	$ 48.00	
Fire Loss Adjustment	144.00	
Unexpired Insurance		$192.00
To write off unexpired insurance canceled by the fire charging proportion to time of fire to expense and the balance to fire loss.		
Cash	5,400.00	
Fire Loss Adjustment		5,400.00
To credit Fire Loss account with amount received from insurance company.		
Capital	369.00	
Fire Loss Adjustment		369.00
To close loss on account of fire to Capital account.		

It is to be noted from the above that the balance of the Fire Loss Adjustment account before settlement with the insurance company represents the amount of the claim against that company and appears in the balance sheet as an asset. After settlement with the insurance company the balance of the Fire Loss account represents either profit or loss on account of fire and appears in the profit and loss statement as an addition to or deduction from the normal net profit for the year.

Fixed Assets and Reserves in the Balance Sheet. — Land appears in the balance sheet at cost. Buildings and the various classes of equipment appear at the book value cost less reserve for depreciation. The section of the balance sheet containing these items appears, therefore, as follows:

Fixed Assets:			
Land		$ 4,500.00	
Buildings (cost)	$18,000.00		
Less-Reserve for Depreciation	2,600.00	15,400.00	
Office Equipment (cost)	$ 1,200.00		
Less-Reserve for Depreciation	480.00	720.00	
Store Equipment (cost)	$ 5,000.00		
Less-Reserve for Depreciation	1,500.00	3,500.00	
Delivery Equipment (cost)	$ 2,400.00		
Less-Reserve for Depreciation	1,200.00	1,200.00	
Total Fixed Assets			$25,320.00

EXERCISE 6-a

Robert Mason who has started in the dry goods business buys store equipment costing $2,675 f.o.b. shipping point. He pays freight charges amounting to $250. The cost of installing the show cases, counters, shelves, etc., is $320. After using the equipment for five years part of it is sold for $380; this part costing installed $640. Provision for depreciation has been made on the basis of 10% per annum and a reserve account set up for this amount.

Required:

(*a*) Entries in general journal form to record purchase and installation of the equipment.

(*b*) Entry to record the annual depreciation.

(*c*) Entry to record sale of equipment and to properly adjust the accounts, using the customary group method.

EXERCISE 6-b

George Tileson has a typewriter in his office for which he paid $115, charging the same to Office Equipment. During five years' use of the machine, $11.50 had been charged to depreciation each year. At the end of the fifth year, although the machine was in good order, Tileson decided that it was no longer suitable for his purpose and bought a new machine for $125, being allowed $50 for the old machine. He paid the balance in cash, $75.

Required:

Prepare all necessary entries to record fully the foregoing transaction.

EXERCISE 6-c

January 1, 1924 The Canton Trading Company began business; at which time it purchased buildings and equipment as follows:

	Cost	Estimated Life
Buildings	$126,000	30 years
Office Equipment	3,600	12 "
Store Equipment	18,000	10 "

December 31, 1924 The books are to be closed and it is desired that depreciation be figured on the above assets on the basis of their estimated life and entries made to adjust the proper accounts.

June 30, 1925 A building carried on the books at $25,000 is sold for $30,000. (Show profit or loss on building disposed of.)

December 31, 1925 Depreciation is charged at the same rates as for the previous year.

April 1, 1926 A calculating machine carried on the books at $480 is turned in as part payment for two smaller machines costing $250 each, $350 being allowed for the old machine. A check is issued for $150.

June 30, 1926 New store equipment to the value of $2,000 is added. Store fixtures costing $1,500 are discarded and sold for $1,000 cash.

December 31, 1926 Depreciation is provided for at the regular rates.

Required:

Entries in general journal form to record all of the above items. Do not use unit depreciation for equipment.

EXERCISE 6-d

On January 1, 19— the Automobile Delivery Truck account of a company stands charged with $4,800 which represents the cost of four trucks numbered 1, 2, 3, and 4 at $1,200 each. At the same time the Reserve for Depreciation of Automobile Delivery Truck account stands credited with $1,800. The following transactions take place:

(1) Truck 5 was purchased July 1, 19— at a cost of $1,500 to replace truck 1. The portion of the reserve for depreciation accumulated on January 1 for truck 1 amounted to $900. Truck 5 was purchased on open account.

(2) August 1, 19—, truck 2 was traded in for $850 on the purchase of truck 6 costing $1,500. The difference was paid in cash. The reserve which had accumulated for depreciation on truck 2 on January 1 amounted to $300.

(3) September 1, 19—, truck 4 was totally destroyed in an accident. The reserve for depreciation on this truck amounted on January 1 to $300 and it was insured for $750.

Required:

Set up entries in general journal form to properly record the above transactions. Depreciation is calculated at the rate of 25% per annum.

Do not neglect to make entries to provide for depreciation for the current year from January 1 to the date that trucks 1, 2 and 4 were disposed of. Use unit depreciation. The apparent profit or loss on account of amount reserved for each truck disposed of is to be charged or credited to Depreciation Adjustment account.

EXERCISE 6-e

July 1, 1924, a firm bought office equipment costing $3,600. The average estimated life of the equipment is considered 12 years and depreciation is charged to General Administrative Expenses and credited to Reserve for Depreciation of Office Equipment on that basis at the end of each fiscal period.

Required:

(*a*) Provide for depreciation for the year ending December 31, 1924.

(*b*) April 1, 1925, a typewriting machine costing $120 was sold for $65 cash and a new machine costing $100 was purchased.

(*c*) Provide for depreciation for the year ending December 31, 1925.

(*d*) September 1, 1926, a fire in the office destroyed an adding machine costing $450. The insurance received was $375. The machine was not replaced.

(*e*) Provide for depreciation for the year ending December 31, 1926.

(*f*) July 1, 1927, the firm goes out of business and the equipment is sold for $2,250.

(*g*) Set up T ledger accounts for Office Equipment and Reserve for Depreciation of Office Equipment. Post entries affecting these accounts and close the reserve account into the asset account to determine the final profit or loss on equipment.

QUESTIONS FOR DISCUSSION

1. Into what classes is equipment for use in the business usually divided and what is the basis for this classification?

2. What is the reason for the periodic adjustment of the ledger accounts with equipment and how is the amount reserved for depreciation determined?

3. What is the relation of the Reserve for Depreciation of Office Equipment account to the Office Equipment asset account?

4. Depreciation is an expense. What determines the title of the expense account to which it should be charged at the time the *reserve* account is *credited?*

5. Reserve for Depreciation accounts always show credit balances. How are they classified according to the debit and credit schedule; i.e., do they represent assets, liabilities, capital, etc.?

6. In adjusting the Reserve for Depreciation of Delivery Equipment at the end of the fiscal period, state what expense account is affected.

7. Criticize the following entries and suggest any changes that may be desirable:

Delivery Equipment	$125.00	
Cash		$125.00
Paid for repairs to truck.		
Real Estate	25.00	
Cash		25.00
Paid for sundry repairs to building.		

8. What is meant by "scrap" or "salvage" value of equipment? How does this affect the rate of depreciation?

9. What is the purpose of a Depreciation Adjustment account and when may it be used?

10. Outline the debits and credits to the Fire Loss Adjustment account. Where does the balance of this account appear in the financial statements?

11. When the insurance company settles a fire loss claim, how is the asset Unexpired Insurance on the books disposed of or adjusted?

12. Name in order the adjustments necessary when an equipment asset is disposed of.

SUMMARY OF CHAPTERS V AND VI

As fixed assets used in a business, such as buildings and equipment, are gradually consumed, the accounts require adjusting at the end of each fiscal

period so that correct profits and net worth may be stated in the financial statements. The part of the asset consumed is known as *depreciation*, and is an *operating expense* of the business. It is estimated at the end of each fiscal period by taking into consideration the cost price of the asset, its length of life, and sale or salvage value, if any.

Land and buildings are entered in separate accounts as land does not depreciate and is not subject to the same charges as buildings. Depreciation figured on single units of equipment is known as *unit depreciation*. When figured on a group or class of equipment it is known as *composite depreciation*. Buildings and expensive machinery are figured by the unit method; in all other cases the composite method is used.

Three accounts are kept with each class of equipment; an asset account which is charged with cost, a reserve account which is credited with the total amount of depreciation to date, and an expense account to which is charged depreciation and maintenance charges. The expense account is closed into Profit and Loss account at the end of each period and appears in the profit and loss statement as an operating expense. The reserve account is deducted from its correlative asset in the balance sheet.

When an asset is taken from service the cost of the asset is credited to the asset account. If the asset has no salvage value and composite depreciation is used, the entire cost is credited to the asset and charged to the reserve account. If sold, the proceeds of the sale are credited to the asset and the balance of cost is credited to the asset and charged to the reserve account. In unit depreciation only that portion of the reserve applicable to the particular asset disposed of is credited to the asset and charged to the reserve. The balance, if any, represents over or under estimate of depreciation and is charged or credited to a Depreciation Adjustment account. A Fire Loss Adjustment account is used in a like manner to show apparent profit or loss on account of fire.

CHAPTER VII

ADJUSTMENT OF ACCOUNTS RECEIVABLE

Necessity for Adjustment. — Where credit is extended to customers, experience shows that even though great care is taken in granting credit some of the outstanding accounts will prove uncollectible. Therefore, unless some provision is made for this loss at the end of a fiscal period, the asset Accounts Receivable will be overstated in the balance sheet and will not represent the true value of what may, probably, be collected from customers. And the net profits for the period will be overstated also.

Provision for Doubtful Accounts. — As it is not known at the close of the fiscal period which of the customers' accounts then owing will not be paid during the subsequent period, the total estimated loss from this source is credited to a *Reserve for Doubtful Accounts* account. The amount thus set aside is considered as an expense of the business and is charged to an account called *Provision for Doubtful Accounts.*

Illustration

A firm has $15,000 due from customers at the close of the period as shown by the Accounts Receivable controlling account and it is estimated that 1% of this amount will prove to be uncollectible during the ensuing period. The following entry is made:

Provision for Doubtful Accounts	$150.00	
Reserve for Doubtful Accounts		$150.00
To provide for estimated loss of 1% of Accounts Receivable outstanding amounting to $15,000.		

The estimated loss on account of extending credit is not primarily an operating expense, but results from the inability of the customer to meet his financial obligations and, therefore, the Provision for Doubtful Accounts account appears in the profit and loss statement under "Other Charges." The *reserve* account which measures the estimated loss is shown in the balance sheet as a deduction from the Accounts Receivable as follows:

Accounts Receivable	$15,000.00	
Less — Reserve for Doubtful Accounts	150.00	$14,850.00

Bad Accounts Charged Off. — When an account proves to be uncollectible, an entry is made in the General Journal, charging the *reserve* account and crediting the customer's account for the amount of its balance in order to close the account. For instance, customer X who owes $100 fails in business and his account is a total loss. The entry is as follows:

Reserve for Doubtful Accounts	$100.00	
Accounts Receivable — X		$100.00
To transfer X's account, which is a loss, to reserve account.		

The *reserve* account should always show a credit balance. However, if the amount continues to increase, it is evident that too great an allowance is being made and it should be reduced. The reserve account should never show a debit balance. If the losses prove to be greater than the *reserve*, the amount set aside for this purpose should be increased. If during the fiscal period the amount of the losses sustained is greater than the balance of the *reserve* account, the difference should be charged to *Loss on Bad Accounts* account. Assuming in the above case that customer X who failed owed $175 and that the credit to the *reserve* was $150, the entry is as follows:

Reserve for Doubtful Accounts	$150.00	
Loss on Bad Accounts	25.00	
Accounts Receivable — X		$175.00

Basis for Estimating Loss. — The percentage rate used is an average determined by past experience. It is an estimate just as depreciation is an estimate. Sometimes the average percentage of loss for an industry based upon the experience of others is used. Or, it may be figured for a given business by taking the average losses for the past five years and dividing by the average of the amounts owed by customers at the end of each of the five years. For example, if the average loss for the past five years is $1,500 and the average amount owed by customers at the end of each year is $150,000 the rate of loss is 1% ($1,500 ÷ $150,000).

Instead of basing the loss on Accounts Receivable some business men prefer to base it on sales, in which case the average loss is divided by the average sales.

Payments of Account Previously Charged Off. — Sometimes an account that has been charged off as worthless is recovered, in which case the accounting process is reversed. For example, assume that the account with customer X for $100 which had been charged off as shown above was later paid in full. The entries are as follows:

General Journal

Accounts Receivable — X	$100.00	
Reserve for Doubtful Accounts		$100.00
To bring onto books account with X charged to reserve as worthless.		

Cash Receipts Journal

Cash	$100.00	
Accounts Receivable — X		$100.00
To record payment of account.		

If a reserve has not been provided and the account is recovered, it is credited directly to Capital. In either case the customer's account is brought onto the books again as a matter of record.

EXERCISE 7-a

The books of T. L. Caskey show a total of $18,260 owing by customers at the close of the fiscal period December 31, 19—. It is estimated that of the accounts outstanding 1½% are doubtful of collection.

Required:

(*a*) Prepare journal entry to provide a reserve for the estimated amount of doubtful accounts.

(*b*) On January 15 of the following year it is found that J. B. Myers, a customer who owes $125.25, has failed. His account is considered to be worthless and it is decided to write it off the books. Prepare the entry to accomplish this.

(*c*) One year later J. B. Myers who has started in business again pays the above-mentioned account in full. Set up proper entries to record the payment of the account.

EXERCISE 7-b

At the time of closing the books and preparing financial statements for a firm at the end of the fiscal year December 31, 19— you are instructed to provide a reserve for doubtful accounts, based upon 1% of the customers' balances amounting to $86,940.

In February of the ensuing year James Reimer, a customer who owes $324, fails and his account is a total loss.

Required:

(*a*) Make entry to provide for the estimated loss on account of bad accounts as of December 31, 19—.

(*b*) Make proper adjustment of the customer's account that is lost, the reserve having been set up for estimated losses sufficient to cover this amount in (*a*).

(*c*) Assuming that no reserve had been provided, show entries to adjust the accounts.

EXERCISE 7-c

On December 1, 19— an account with W. C. Burt which shows a balance of $222.20 proves to be uncollectible and it is desired to write it off the books. A Reserve for Doubtful Accounts has been provided which at this time shows a balance of $458.20.

On December 31, 19— it is desired that the balance of the Reserve account be adjusted to such an amount as will make it equal to $1\frac{1}{2}\%$ of the outstanding customers' accounts amounting to $45,620.

Required:

Prepare journal entries to make adjustments in accordance with above data.

EXERCISE 7-d

At the close of the year 1% of the sales amounting to $224,530 is set aside to provide for losses on doubtful accounts. On April 1 of the ensuing year R. T. Owen, who owes $740, fails and settlement is made for 50¢ on the dollar.

Required:

Prepare journal entries to set up reserve and adjust Owen's account.

EXERCISE 7-e

On April 30, 19— the Reserve for Doubtful Accounts shows a balance of $945. At this time accounts of customers aggregating $1,278.20 are found to be bad and cannot be collected. They are written off the books.

On June 30, 19—, the end of the fiscal period, it is decided to provide for future losses to the extent of 2% of the outstanding customers' accounts amounting to $29,450.

Required:

(*a*) Prepare journal entries to adjust the accounts on April 30, 19— and to set up the reserve at the close of the fiscal year.

(*b*) Illustrate how the reserve account should be shown in the balance sheet.

EXERCISE 7-f

On December 31, 19— at the time of closing the books for the year ending that date, C. V. Conway & Co. set aside 1% of the amount due from customers as a Reserve for Doubtful Accounts. The amount due from customers on that date amounted to $94,540.24.

On September 15, 19— the accounts of D. C. Pierce for $245.30, and of Geo. Goodwin & Co. for $98.10 are found to be uncollectible and are written off the books.

On November 30, 19— the trustees in bankruptcy for William B. Blake & Co. send a check for final dividend of 30% to apply on a claim of $862.20 filed with them. They had previously remitted a dividend of 50%.

Required:

(*a*) Prepare journal entries to make adjustments in accordance with the foregoing data.

(*b*) Show T ledger accounts for Accounts Receivable and Reserve for Doubtful Accounts accounts after making the entries called for in (*a*).

QUESTIONS FOR DISCUSSION

1. What is the purpose of the account Reserve for Doubtful Accounts, and what entry is made to establish the same?
2. What relation does the Reserve for Doubtful Accounts have to the asset Accounts Receivable?
3. How is the amount to be set aside for Reserve for Doubtful Accounts determined?
4. What is the effect upon the reserve account when a customer fails and his account becomes a total loss?
5. Outline the procedure for charging an account off the books.
6. Should the reserve account ever show a debit balance? Explain.
7. What is done when an account that has been charged to the *reserve* account is paid by the customer?
8. Assuming that losses due to bad accounts are much heavier than anticipated and the *reserve* account is all used up, what is done with further losses?
9. How should the Reserve be shown in the balance sheet?
10. Under what expense group should Provision for Doubtful Accounts be shown in the profit and loss statement?
11. What effect does the loss of J. B. Myers' account in Exercise 7-a have upon the amount of the net profit for January?
12. Which fiscal period is affected by the loss of Reimer's account in Exercise 7-b under conditions as stated in (*b*) and (*c*)?

CHAPTER VIII

DEFERRED CHARGES TO EXPENSE

Need for Consideration. — In order that the profit and loss statement may show the accurate cost of doing business for a fiscal period and that the balance sheet may contain an accurate list of the assets of the business at the close of the period, it becomes necessary to adjust or correct certain expense and asset accounts. Such items as office and automobile supplies, when purchased during the fiscal period, are charged to some expense account. At the close of the fiscal period some of these supplies are often unconsumed. The *consumed* portion of such items increases the expenses of that period and should appear in the profit and loss statement as an expense. The part that is *unconsumed* is an asset and should appear in the balance sheet. In like manner, services are purchased during the period and charged to some expense account. Any part of this service that has not been rendered at the close of the period, therefore, becomes an asset of the business. Insurance, advertising, and interest paid in advance are examples of this type of asset.

Entries to Adjust Accounts Affected. — At the end of the fiscal period the balance of each account in the ledger should represent either an asset, a liability, capital, expense or income. Those accounts that show more than one of these elements at the same time are known as *mixed* accounts. Expense accounts containing items not entirely consumed in the business are mixed accounts. In like manner asset accounts to which are charged items, some portion of which have been consumed, are mixed accounts. An entry must be made to separate the used from the unused portion of such items; the *used* portions become expenses for the current period, while the unused portions, or the balances, remain as assets until they are consumed during the next fiscal period. They then become expense. A deferred charge to expense, therefore, refers to supplies or services purchased in one period but consumed in the following period.

Illustration No. 1

Office Supplies. — A firm charges all stationery, pencils, ink, etc., purchased during a fiscal period, to an account called *Office Supplies*. At the end of the period this account shows a debit balance of $245, and supplies on hand amount to $65. The difference, therefore, represents the value of the supplies used.

The following entry is made to transfer the asset to a separate account so that it will not be charged to the expense of the current period:

December 31, 19—

Office Supplies on Hand	$65.00	
Office Supplies		$65.00
To transfer from the expense account and set up as an asset the value of office supplies on hand.		

Before making the above entry the Office Supplies account was a mixed account as it contained both an expense and an asset element. After adjusting the account, or removing the inventory, it shows only *expense* and is closed into Profit and Loss account with other expense accounts. Inasmuch as the *inventory* of office supplies will probably be used during the next period, the following entry is made after the books are closed to place the inventory back into the expense account and close the Office Supplies on Hand account:

January 1, 19—

Office Supplies	$65.00	
Office Supplies on Hand		$65.00
To transfer value of office supplies on hand at close of fiscal period to expense account.		

The account with *Auto Supplies* is handled in the same manner. If office supplies are charged to General Administrative Expenses account when purchased, that account, instead of Office Supplies account, must be credited when the adjustment is made. In like manner, if auto supplies are charged to Delivery Expenses account when purchased, Auto Supplies on Hand account is debited and Delivery Expenses account credited for the cost of the supplies on hand at the close of the period. This entry is then reversed as above.

Illustration No. 2

Insurance. — A firm's fiscal year ends December 31. January 1, insurance is taken out for three years; the premium paid, amounting to $120, is charged to Insurance Expense account. Therefore, on December 31, two-thirds of the insurance is prepaid and represents an asset. The entry to adjust is as follows:

December 31, 19—

Insurance Unexpired	$80.00	
Insurance Expense		$80.00
To transfer from expense account and set up as an asset the value of insurance paid in advance.		

This entry may be reversed the same as that for office supplies. Inasmuch as this insurance will not all be used during the next period no further entry need be made until the end of the next fiscal period. The entry then will be as follows:

December 31, 19— (one year later)

Insurance Expense	$40.00	
Insurance Unexpired		$40.00
To transfer from the asset account and charge to expense the value of expired insurance for the period.		

Insurance is always paid in advance and is usually taken out for a term covering more than one accounting period. Therefore, when purchased, it may be charged to the asset account. The asset account is then adjusted at the end of each period by transferring the amount *used* to a related expense account, as shown in the foregoing entry.

Illustration No. 3

Interest. — When money is borrowed from a bank on a note, it is customary for the bank to deduct interest in advance from the maturity value of the note issued for the loan. Assume that a firm discounts its 60-day note for $10,000 at the bank, December 1, at 6%, the fiscal year ending December 31. At the time of discounting the note the entry is as follows:

December 1, 19—

Cash	$9,900.00	
Interest Expense	100.00	
Notes Payable		$10,000.00

At the end of December, *one* half of the $100 interest charge has expired; the *other* half, paid in advance, is unexpired and represents an asset of the firm. The entry to adjust is as follows:

December 31, 19—

Interest Prepaid	$50.00	
Interest Expense		$50.00
To transfer from the expense account the value of interest on notes payable paid in advance.		

Inasmuch as the value of this asset will be realized by the firm during the next period an entry is made to reverse as follows:

January 1, 19—

Interest Expense	$50.00	
Interest Prepaid		$50.00

To transfer value of interest prepaid at close of period to expense account.

Illustration No. 4

Advertising. — This account may be charged both with supplies purchased, such as circulars, cards, etc., and with contracts for newspaper space, etc. It consists, therefore, of *material* which will be inventoried and *services* which will be prorated over the periods receiving the benefit therefrom, in the same manner as is interest in the foregoing illustration.

Assume that a firm has purchased circulars and advertising matter amounting to $650. July 1, they enter into a contract with an advertising agency for publicity to extend over a period of one year for which $600 is paid. December 31, it is necessary to take an inventory of the supplies which are found to cost $250. It is obvious that one-half of the advertising contract has been carried out and, therefore, represents expense of $300. The entry to adjust is as follows:

December 31, 19—

Advertising Prepaid	$550.00	
Advertising		$550.00

To transfer from expense account the value of unused advertising as follows:

Circulars, etc., on hand	$250
Advertising contract—	
one-half year @ $600 per year	300
Total, as above,	$550

As this material will probably be used during the next period and the contract expires during the period, the foregoing entry should be reversed under date of January 1, as in previous examples.

How Shown in Financial Statements. — The effect of each of the adjustment entries illustrated is to *decrease* some *expense* account by crediting that account and to *increase* some *asset* by debiting such account. The *balance* of the *expense* account in each instance, after deducting the unused or asset portion, is carried to the Profit and Loss account in the ledger and to the profit and loss statement. All the expense accounts illustrated represent operating

expenses, except Interest which is a financial expense and appears under Other Charges. The asset items appear in the balance sheet under a separate heading called Deferred Charges. As these items are usually small in amount and are not worth cost value to any one except the firm itself, this group appears as the last on the asset side of the balance sheet as follows:

Deferred Charges:		
Office Supplies on Hand	$ 65.00	
Insurance Unexpired	80.00	
Interest Prepaid	50.00	
Advertising Prepaid	550.00	$745.00

EXERCISE 8-a

At the close of the fiscal year ending December 31, 19— the trial balance of a firm before making any adjustments contained the following expense accounts:

Automobile Supplies	$ 420.00
Advertising	680.00
Office Supplies	220.00
Insurance	130.00
Taxes	380.00
Interest Expense	75.00
Rent	1,500.00

The following items affecting the above accounts are to be considered in adjusting the accounts preparatory to making financial statements:

(1) The inventory shows automobile supplies on hand, the cost price being $76.

(2) Advertising material on hand cost $125; also six months' advertising contract, dated November 1, for which $450 was paid.

(3) Stationery and miscellaneous office supplies on hand cost $65.

(4) Insurance policies in force as follows: Automobile, dated July 1, 19— for one year, premium $85; on office equipment, dated September 1 (previous year), for three years, premium $42.

(5) On October 1, 19— taxes amounting to $220, for year ending April 1 next, were paid.

(6) On November 16, 19— the firm discounted at the bank their 60-day note for $500 at 6%.

(7) The office rent is $100 per month. On December 15 a check for $200 was issued in payment of December and January rent.

Required:

(*a*) Prepare journal entries as of December 31, that will result in adjusting the expense accounts referred to above so that they will show only the expense belonging to the current fiscal period.

(*b*) Make reversing journal entries as of the following January 1, to close the Deferred Charges accounts into the proper expense accounts.

EXERCISE 8-b

Prepare adjusting journal entries for the year ending June 30, 19—, in accordance with the following data:

(1) Make provision for doubtful accounts on the basis of $1\frac{1}{2}\%$ of the amount due from customers at the end of the fiscal year. The Accounts Receivable account shows a balance of $12,960.20.

(2) A physical inventory reveals office supplies on hand which cost $148. Office supplies when purchased were charged to General Administrative Expense.

(3) The inventory shows automobile supplies on hand costing $150. Automobile supplies when purchased were charged to Delivery Expense.

(4) On January 1, the equipment was insured for a period of three years, the premium being $270. When paid this was charged to Insurance Prepaid.

(5) Provide for depreciation of the following property:

Buildings costing $50,000 at 2% per annum
Office equipment costing $1,850 at 10% per annum
Delivery equipment costing $1,500 at 25% per annum.

(6) During the year an office desk costing $45 was sold for $5, which amount was credited to the Office Equipment account, and a new desk purchased for $50 to take its place and charged to this account. No entry was made at the time of purchase to adjust the asset account for the desk disposed of.

Required:

Entries in general journal form to adjust the accounts in accordance with the above particulars.

EXERCISE 8-c

At the time of closing the books on December 31, 19—, for the year ending on that date, a firm has the following items that need adjusting:

(1) A tract of land was purchased for $12,000. During the year $3,000 was expended on the land for grading and improvements after which the tract was divided into 10 building lots. Five of these lots were sold during the year for $10,000, which amount was credited to the Land account. The lots are considered of equal value.

(2) Five old typewriters were exchanged for five new ones, the firm paying $75 in cash for each of the new ones, which amount was charged to the Office Equipment account. The allowance for each of the old typewriters was $25. The average cost of the old typewriters was $110 each. Depreciation had been provided for at the rate of 10 per cent per annum for eight years and credited to Reserve for Depreciation of Office Equipment account. No entry was made for the old typewriters at the time they were disposed of.

(3) Interest Expense account shows a debit of $96. At the close of the period the following notes payable are under discount at the bank:

$4,000 dated December 1, 19—, 90 days, discount 6%
$1,260 dated November 15, 19—, 60 days, discount 5%

Required:

Entries in general journal form to adjust accounts in accordance with the foregoing data.

QUESTIONS FOR DISCUSSION

1. Why is it that expense accounts to which supplies of various kinds have been charged frequently need adjusting at the close of the accounting period?
2. What is meant by the term "Deferred Charges to Expense" and why is it applied to certain assets?
3. Inasmuch as all wasting assets such as buildings and equipment eventually become expense, why are they not classified as "Deferred Charges" also?
4. What is the purpose of making a reversing entry at the beginning of a new accounting period whereby the deferred charges are transferred to the expense accounts?
5. Assume that the office supplies on hand at the close of a period amounted to $75 and that a reversing entry was not made at the beginning of the next period, so that at the end of the subsequent period Office Supplies on Hand account showed a balance of $75; the Office Supplies account showed a charge of $240 for supplies purchased during the period and the inventory at the close of the subsequent period amounted to $105. How would the adjustment be made?
6. In what way does the handling of the Insurance account frequently differ from other items of this class?
7. Are "Deferred Charges" classified as Current or Fixed assets? Why are they shown in a separate group on the balance sheet?
8. Give a reason for placing the "Deferred Charges" group of assets last on the asset side of the balance sheet.
9. What would be the effect upon the net profit of a business if deferred charges were not considered in preparing the financial statements?
10. How is the amount of deferred interest and insurance determined for the purpose of adjustment and how does this differ from office supplies?

CHAPTER IX

DEFERRED CREDITS TO INCOME

Need for Consideration. — Just as Deferred Charges consist of expense items purchased in one fiscal period and not used or earned until the following period, so Deferred Credits to Income consist of those income items collected or credited in one period and not used or earned until the following period. A common example is *rent* collected in advance. If an office is rented December 15 for $50 per month payable in advance, and the fiscal year ends December 31, it is obvious that only one-half the rent income has been earned and that $25 rent is owing the tenant. The income account for the current period should, therefore, be charged with $25, and a deferred income, or liability, account credited with $25 owing the tenant, which will be added to the income of the ensuing period when earned. Income in the form of *interest* is another item sometimes received in advance and must be adjusted.

Relation to Deferred Charges. — In many cases a deferred credit on one set of books represents a deferred charge on another set of books. For instance, the rent collected in advance is a deferred credit for the one receiving it and a deferred charge for the one paying it. Interest paid in advance is a deferred income for the bank receiving it but a deferred charge for the one paying it. In like manner insurance and advertising prepaid are deferred income to the insurance company and the advertising agency.

Entries to Adjust Accounts Affected. — At the close of the fiscal period it is necessary to make entries to adjust the income accounts affected, which are mixed accounts, so that the earned income may be included with the current year's income while the unearned income or the income paid in advance may be shown as a liability and deferred as income until the following period when earned.

Illustration No. 1

Rent Income. — A firm rents a part of its building, December 1, to another firm at $150 per month, payable three months in advance. The fiscal year ends December 31. At the time the rent is collected the following entry is made:

December 1, 19—

Cash	$450.00	
Rent Income (or Buildings Expense and Income)		$450.00
Received rent of building for three months in advance at $150 per month.		

If the building is owned by the firm and an account is kept in the ledger with Buildings Expense and Income, the rent collected is credited to that account and the adjustment is also made through that account. Such an adjustment has the effect of increasing the Buildings Expense account.

At the end of the year the following adjusting entry is made:

December 31, 19—

Rent Income (or Buildings Expense and Income)	$300.00	
Rent Income Prepaid		$300.00
To transfer from income account the amount of rent paid in advance (2 months at $150) and set up liability for same.		

At the beginning of the next fiscal period the following transfer entry is made:

January 1, 19—

Rent Income Prepaid	$300.00	
Rent Income (or Buildings Expense and Income)		$300.00
To transfer value of rent prepaid at close of period to the income account.		

Illustration No. 2

Interest Income. — December 16, a customer is permitted to settle an account for $1,200 with a 60-day note, provided he pays interest on the same, cash in advance. At the time of settlement of the account the entry is as follows:

December 16, 19—

Cash	$ 12.00	
Notes Receivable	1200.00	
Accounts Receivable — Customer		$1200.00
Interest Income		12.00

At the close of the year the following adjusting entry is made:

December 31, 19—

Interest Income	$9.00	
Interest Income Prepaid		$9.00
To transfer from income account and set up as a liability unearned interest on customer's note for 45 days at 6%.		

At the beginning of the next period the transfer entry is as follows:

January 1, 19—

Interest Income Prepaid	$9.00	
Interest Income		$9.00
To transfer interest prepaid at close of period to the income account.		

In both of the foregoing illustrations the balance of the income account after adjusting is closed into Profit and Loss account at the time of closing the books.

How Shown in Financial Statements. — While deferred charges decrease expense accounts, deferred credits have the opposite effect; they decrease income accounts and carry the unearned part of the same forward into the next fiscal period. The balance of the income account, or the earned portion, is then credited to the Profit and Loss account in the ledger and appears in the profit and loss statement under *Other Income*. The unearned items appear in the balance sheet as liabilities. This liability stands for some service to be rendered during the next period rather than for the payment of cash; nevertheless, it is a legal claim against the firm.

These items may be listed under Current Liabilities or may appear under a separate heading, *Deferred Credits*. As the amount of deferred credits is usually small in an ordinary trading concern, they usually appear under the *Current Liability* group.

EXERCISE 9-a

At the close of the year, December 31, 19—, the following accounts appear in the ledger of a firm:

Interest Income	$ 64.00
Delivery Expense	460.00
Rent	1,800.00

The following items will be considered in adjusting the above accounts:

(1) Interest has been collected in advance on a customer's 60-day note for $850, dated November 25, 19—, interest 6%.

(2) Part of a garage is sublet to another firm at $15 per month payable on the 15th of the month in advance. On December 15 a month's rent was received and credited to Delivery Expense.

(3) Part of the building is sublet for $75 per month and credited to Rent account as paid. On December 1 a check for $150 was received for December and January rent.

Required:

(*a*) Journal entries as of December 31, 19— to adjust accounts.

(*b*) Reversing journal entries as of January 1, 19— to close deferred credit accounts into the proper accounts.

EXERCISE 9-b

The books of a concern are to be closed for the fiscal year ending June 30, 19—. The following items need adjusting before the financial statements are made up:

(1) No depreciation has been provided for on any of the assets, all of which were purchased at the time of starting business on July 1 of the previous year.

	Cost	Estimated Life
Office Equipment	$ 870.00	10 years
Store Equipment	2,500.00	12 "
Two Delivery Trucks	2,000.00	5 "

A dictaphone costing $200 was sold on March 1, 19— for $125. This amount was received in cash and credited to Office Equipment. No other entry was made.

(2) A 90-day note for $2,000 with interest at 6% was discounted at the bank on June 1, 19— at 6%, the discount being charged to an account with Interest Expense.

(3) Insurance on the trucks was taken out on July 1 of the previous year for three years, the premium paid being $52. This amount was charged to Insurance Prepaid.

(4) On June 30, 19— the stenographer left for two weeks' vacation and received three weeks' pay at $25 a week, two weeks being paid in advance.

(5) During the year the firm took over a second mortgage on a house owned by a member of the firm for $4,000 at 8%, interest payable May 1 and November 1. This was taken over on condition that the interest be paid in advance. On May 1 interest for six months was received.

(6) Desk space has been rented to an insurance agent for $25 a month payable in advance. The July rent was received on June 30.

Required:

(*a*) Journal entries to adjust the accounts involved in the above transactions.

(*b*) Assuming that the profit before adjusting was $6,750, show the effect of each of the above adjustments on the profit, using a ledger account with Profit and Loss.

(*c*) Show where the accounts used in the above adjustments would appear in the financial statements.

QUESTIONS FOR DISCUSSION

1. Explain the difference between Deferred Charges and Deferred Credits.
2. Why are income accounts that contain prepaid items termed mixed accounts?
3. In Exercise 9-a (3), rent collected for subletting building was credited to Rent account. To what other account or accounts might this item be credited?
4. The usual effect of setting up a deferred credit on the books is to decrease some income account. Name the exception.
5. What is the effect upon the net profit for the period if no adjustment is made on account of income collected in advance?
6. Name some special lines of business that should give special attention to Deferred Credits to Income.
7. In what way would this apply to a private school or college?
8. A magazine collects subscriptions in advance and credits same to an income account called "Income from Subscriptions." At the end of the fiscal year, how should the accounts be adjusted?

SUMMARY OF CHAPTERS VII–IX

Some of the accounts receivable owing at the end of the fiscal period will be lost during the ensuing period through failure of the customers to pay. The estimated loss is charged to an expense account, *Provision for Doubtful Accounts*, and credited to a *Reserve for Doubtful Accounts* account. During the ensuing period when the loss takes place it is charged to the Reserve for Doubtful Accounts account and credited to the customer's account. This adjustment charges the loss to the period when the sale was made.

Services and supplies charged to expense accounts and not consumed at the end of the fiscal period are set up as assets. These assets become expenses during the ensuing period and are known as *Deferred Charges*. Deferred charges *increase assets* and *decrease expenses*. Deferred charges appear in the balance sheet under a separate heading among the assets. Services and expenses consumed are operating expenses and appear in the profit and loss statement.

Rent, interest, and similar services paid for by others in advance are known as *Deferred Credits*. They are deducted from the income account and credited to a liability account until the ensuing period when they become income. Such items *increase liabilities* and *decrease income*. Deferred income items appear in the balance sheet as current liabilities. Rent, interest, etc. earned are shown as Other Income in the profit and loss statement.

These adjustments have the effect of separating *mixed* accounts into their component elements and thus exclude from the expenses and income of the current period expenses and income belonging to the ensuing period.

CHAPTER X

ACCRUED INCOME

Need for Consideration. — There are two methods of accounting for income, as follows:

1. *Cash Basis.* The income increases the profits of the fiscal period in which it is *collected*, regardless of the period when it was *earned*.

2. *Accrual Basis.* The income increases the profits of the fiscal period when *earned* regardless of the period when it was *collected*. The Accrual Basis must be used to make it possible to ascertain the true profit or loss for the current fiscal period. At the end of an accounting period there are frequently items of income that have been earned but which are not due and do not appear on the books. The most common item of this kind is *interest* which, while it accrues from day to day, is not usually recorded as income until collected.

If a 60-day interest-bearing note is received from a customer, December 16, the interest will not be due until the note is paid, February 14. At the close of the fiscal period, December 31, this note has earned interest for 15 days. This interest does not appear on the books, but it should be included with the income for that period. Likewise, investments in mortgages and bonds may have earned interest which will not become due and be collected until the subsequent period. Unless such items are taken into consideration and the asset and income accounts adjusted, the statements will not reveal the true financial standing of the concern at the close of the fiscal period.

Compared With Deferred Charges. — Accrued income refers to items of income *earned* in one fiscal period, but not due and, therefore, not *collected* until the following period. At the end of the fiscal period they represent obligations in favor of the concern somewhat similar to notes and accounts receivable and are, therefore, assets. They have not been recorded, however, and are not included in the income on the books.

Deferred charges, on the other hand, refer to unconsumed expense items that have been recorded, and are in the nature of inventories. Accrued income items, therefore, *increase income* while deferred charges *decrease expense*. Both increase assets but they result from transactions that differ in nature.

Entries to Adjust Accounts Affected. — When income such as interest is *collected*, the asset Cash is debited and the Interest Income account is credited.

At the end of the period a similar entry is made for interest *earned* but not paid except that *Accrued Interest Income* is debited instead of Cash. Adjustments of this type increase both the asset and the income account.

Illustration No. 1

Interest Income. — A 60-day note for $2,400, bearing interest at 6%, is received from a customer December 1. The fiscal year ends December 31. When the note is received, Notes Receivable is debited and the customer credited for the face of the note. At the close of the period, December 31, the note has earned 30 days' interest amounting to $12, which is an asset. The following adjusting entry is made to record the interest earned:

December 31, 19—

Accrued Interest Income	$12.00	
Interest Income		$12.00
To record accrual of interest on $2,400 note, dated December 1, for 30 days at 6%.		

As this interest will be paid during the subsequent period, the following transfer entry is made at the beginning of that period:

January 1, 19—

Interest Income	$12.00	
Accrued Interest Income		$12.00
To transfer interest accrued at the close of period to the income account.		

When the note is paid the entry is as follows:

January 30, 19—

Cash	$2,424.00	
Notes Receivable		$2,400.00
Interest Income		24.00
To record payment of note with interest.		

The effect of the above entries is to credit each period with the proportion of the interest earned during that period. The ledger account with Interest Income, if this is the only item recorded therein, is as follows:

Interest Income

19--						19--					
Dec.	31	To P. and L.		12	00	Dec.	31	Accrued		12	00
19--						19--					
Jan.	1	Reversed		12	00	Jan.	30	Cash		24	00
Dec.	31	To P. and L.		12	00						
				24	00					24	00

Illustration No. 2

Income from Investments. — Among the assets of a firm is Investments, $10,000, which consists of bonds bearing 5% interest payable semi-annually, April 1 and October 1. On December 31 three months' interest has accrued on these bonds, amounting to $125. The following entry adjusts the accounts:

December 31, 19—

Accrued Income from Investments	$125.00	
Income from Investments		$125.00
To record accrual of interest on $10,000 bonds from October 1 to December 31 at 5%.		

At the beginning of the next period the entry to reverse the above entry is made as follows:

January 1, 19—

Income from Investments	$125.00	
Accrued Income from Investments		$125.00
To transfer income accrued at the close of the period to the income account.		

The entry for the collection of the income on April 1 is as follows:

April 1, 19—

Cash	$250.00	
Income from Investments		$250.00
To record receipt of six months' interest on bonds — $10,000 at 5%.		

Another accrued income item is rentals earned but not due. For instance, if part of the building is rented, December 15, the rental to be paid on the fifteenth of each month for the month ending on that date, on December 31 one-half month's rent is earned but will not be due and collected until January 15. The entries to adjust are similar to those shown above for interest income and

income from investments. Sometimes rentals are not paid when due and are thus both *accrued and due* at the close of the period. If the tenant neglected to pay his monthly rent on December 15 that was due on that date and the amount were not charged to his account at that time, on December 31 there would be 1½ months' rental earned and not recorded, one month of which is due and one-half month earned but not due. All of this is an asset which should be recorded and added to the income for the current period.

Commissions earned during the period and not recorded at the close of period should be brought onto the books in the same manner as the foregoing items.

How Shown in the Financial Statements. — The above adjustment entries increase assets by debiting some accrued asset account and increase income by crediting some income account. The total of the income account after adding the income accrued is carried to the Profit and Loss account in the ledger and to the Other Income section of the profit and loss statement. The asset items appear in the balance sheet listed separately under the Current Asset group:

Current Assets:		
Cash		xx xx
——		xx xx
——		xx xx
Accrued Items:		
Interest Income	$ 12.00	
Income from Investments	125.00	
Rent Income	50.00	
Commissions Earned	250.00	437.00

EXERCISE 10-a

On December 31, 19— a firm has the following interest-bearing notes receivable:

S. W. Allan, $950, dated November 1, 19— for 3 months, interest at 6%.

A. E. Mosher, $1,750, dated December 16, 19— for 60 days, interest at 5%.

Required:

(*a*) Journal entry to record the accrual of interest on December 31.

(*b*) Reversing journal entry as of January 1 of the ensuing year to close the accrued asset account.

(*c*) Journal entry to record payment of notes and interest during the ensuing period.

EXERCISE 10-b

A business concern closes its books every six months. At the time of closing the books on June 30, 1926, the following interest-bearing note was on hand:

The Ajax Lumber Co. for $3,500, dated May 15, 1926, for 90 days, interest at 6%.

During the ensuing six months the above note was paid and interest was collected on other notes receivable amounting to $124.30.

December 31, 1926, there were on hand the following interest-bearing notes:

George Gordon, $600, dated December 10, for 30 days, interest at 6%.

William Rogers, $1,000, dated November 25, for 60 days, interest at 8%.

Required:

(*a*) Journal entries to record accrual of interest on June 30, 1926, and close the income account into Profit and Loss.

(*b*) Reversing Journal entry as of July 1, 1926, to close the Accrued Interest Income account.

(*c*) Journal entry to record the payment of Ajax Lumber Company note, and other interest collected during the following period.

(*d*) Journal entry to record accrual of interest on December 31, 1926.

(*e*) Journal entry, Dec. 31, 1926, to close the Income account into Profit and Loss.

(*f*) Set up ledger accounts with Accrued Interest Income and Interest Income, and post the above entries.

(*g*) Assuming that the reversing entry was not made on July 1 and that when paid the interest on the Ajax Lumber Company note was credited to the income account, how will the adjustment be made December 31?

QUESTIONS FOR DISCUSSION

1. (*a*) Explain the difference between the *Cash* and the *Accrual* basis of accounting for income.

(*b*) Which method is of more value to the owners of the business? Why?

2. What is meant by accrued income and why is it important that it be considered in preparing the financial statements?

3. Does the adjustment due to accrued income involve the use of mixed accounts? Explain just what accounts are affected.

4. How do accrued income items differ from deferred charges to expense?

5. Accrued income usually refers to items accrued or earned but *not due*. Give an example of such an item earned and *due*.

6. An investment account consists of bonds bearing interest at 5%, payable April 1 and October 1. What adjustment of the accounts is necessary at the close of the fiscal year ending December 31?

7. Explain how the accrued income items set up at the close of a fiscal period are handled during the subsequent period.

8. How are accrued income items shown in the balance sheet?

9. Mortgage Receivable is a fixed asset. Where is the interest accrued on same at the end of the fiscal period shown in the balance sheet?

10. Explain why accrued income items may be referred to as accrued assets.

11. Is an accrued asset account used to record transactions *during* the fiscal period?

CHAPTER XI

ACCRUED EXPENSES

Need for Consideration. - There are usually a number of expense items that have been incurred in the conduct of the business during the fiscal period which have neither been paid for nor brought onto the books at the time of preparing the statements. Unless a record of such items is made, the statements wili not show the true profit or loss for the period. Charges for wages, interest and other such expense are usually not recorded until paid. Therefore, at the end of the period there are often a number of expenses that have been incurred but which will not be paid until the following period.

These items are opposite in their nature to accrued income. Accrued income increases income and assets; accrued expenses increase expenses and liabilities. Accrued expenses, therefore, refer to expenses which must be included with the cost of operations for the current period, but the payment of which is deferred until the following period. For example, if wages are paid on Saturday of each week and the close of a fiscal period falls on the following Wednesday, the workmen at that time have earned three days' pay which is a part of the expenses of the current period, but which will not be paid until the following Saturday. There will always be accrued wages when the statements are prepared, unless the last day of the fiscal period falls on pay day.

Compared with Deferred Income. — *Deferred income* refers to services to be rendered to others which have been paid for in advance; *accrued expenses* refer to services which have been rendered by others, but have not been paid for. The former is a liability to render services for which pay has been received; the latter is a liability to pay for services already received.

Entries to Adjust Accounts Affected. — Care must be taken to ascertain if all expenses belonging to the current period have been included in the accounts. Those not recorded should be charged to their related expense account and credited to some liability account. All such items are sometimes credited to a single liability account called Miscellaneous Expenses Accrued, but it is better practice to have the account title indicate the nature of the item covered by the liability.

Illustration

Wages Accrued. — A firm, whose fiscal year ends June 30, paid the payroll for the week ending June 28. The payroll for the week ending July 5 amounted

to $840. It is evident that wages for two days must be added to the expenses for the period ending June 30. The following adjusting entry is made for this purpose:

June 30, 19—

Wages	$280.00	
Wages Accrued		$280.00
To record accrual of wages for two days, weekly payroll being $840.		

The expense account to be charged when making the adjustment depends upon the accounts found in the ledger. Wages of office employees may be charged to General Administrative Expenses and those of the sales force to Selling Expenses, etc.

In order to simplify the accounting at the time of payment of the wages a reversing entry is made in accordance with the principles previously explained for other types of adjustments:

July 1, 19—

Wages Accrued	$280.00	
Wages		$280.00
To transfer wages accrued at the close of last period to expense account.		

When the next pay day comes around the entire amount is charged to Wages, which automatically adjusts the expense account. Similar entries are made for such items as taxes, interest accrued on notes and mortgages payable, etc., rent owing, and sundry other items the benefits from which have been received but which have not been recorded on the books.

How Shown in Financial Statements. — The above adjustments increase both expenses and liabilities. The expense accounts after adding the expenses accrued are carried to the Profit and Loss account in the ledger and to the Operating Expense section of the profit and loss statement. The liabilities for accrued expenses should appear in the balance sheet, listed as the last items in the Current Liability section. They may be shown as follows:

Current Liabilities:		
Accounts Payable		xx xx
		xx xx
Accrued Items:		
Wages	xx xx	
Taxes	xx xx	
Interest Expense	xx xx	
Rent Expense	xx xx	xx xx

Importance of Making Proper Adjustments. — Such items as interest and rent appear under more than one type of the adjustments explained; therefore, a thorough understanding of the nature of the items to be adjusted is very important. For instance, *interest paid in advance by the firm* on obligations it owes is a *Deferred Charge*. *Interest paid in advance by others to the firm* on obligations owing to the firm is a *Deferred Income*. *Interest earned on obligations owing to the firm* at the close of the period and not recorded on the books is *Accrued Income*. *Interest earned on obligations owing to others by the firm* but not on the books is *Accrued Expense*. The principal thing to bear in mind is that it is necessary to *include in the statements all income and expense* properly belonging to the current fiscal period whether paid or not, and to *exclude all income and expense* not belonging to the period, even though payment has been made for the same during the period.

EXERCISE 11-a

At the time of closing the books at the end of the fiscal year, December 31, 1926, the Jones Trading Co. has outstanding a mortgage payable for $10,000 which falls due June 1, 1927; interest at 6% payable June 1 and December 1. The mortgage together with accrued interest to date is paid in full on June 1, 1927.

Required:

(*a*) Journal entries to record accrual of interest on December 31, 1926.

(*b*) Entry as of January 1, 1927 to reverse the adjusting entry made on December 31, 1926.

(*c*) Entry to record payment of mortgage and accrued interest on June 1, 1927.

(*d*) Assuming that reversing entry (*b*) was not made on January 1, 1927, how would the payment be recorded?

EXERCISE 11-b

Accrued interest on notes payable as of June 30, 19— amounted to $70. During the ensuing three months, interest on notes payable amounting to $140 was paid. On December 31, 19— the amount of accruals was $45.

Required:

Ledger accounts to illustrate the method of handling above items, assuming the books to have been closed on June 30, and reversing entry to have been made on July 1.

EXERCISE 11-c

At the time of closing the books and preparing statements for the T. M. Marsh Co. for the year ending Dec. 31, 19— the following accrued items are considered:

1. Interest earned on the following notes receivable on hand:

   60-day note from T. B. Fallon for $1,500 dated November 30, 19—; interest 6%.

2. Accrued interest on notes payable outstanding to J. A. Dorn at 90 days for $900, dated December 7, 19—; interest 8%.

3. Wages remain unpaid for two days. The weekly payroll is as follows: General office, $360; delivery department, $150; salesmen, $240.

4. Taxes accrued on vacant lot assessed at $1,200 and on store building at $80,000 from April 1. Last tax rate $27.20 per thousand.

5. Interest on mortgage on store building for $40,000 at 6%. Interest payable April 1 and October 1.

6. Rents receivable due but not paid, $150.

7. Commission earned and not collected for selling goods received on consignment, $125.

8. Interest payable January 1 of the following year on bonds owned amounts to $160.

Required:

Journal entries that properly adjust all accounts affected.

EXERCISE 11-d

The following items are to be considered in preparing financial statements for the month of January:

1. Office supplies purchased during the month, $250; unused at the close of the month, $190.

2. Depreciation of office equipment at the rate of 10% per annum; book value, $900; accounting period, one month.

3. Due from customers on open account, $23,500. Make provision for reserve for doubtful accounts to the extent of 3% of the amount due.

4. Interest collected, $45; interest accrued on notes in the safe, $15.

5. Interest accrued on notes payable at the close of the month, $75; accrued on mortgage payable, $150.

6. Unpaid rent due landlord for office, $250.

7. Depreciation on automobile costing $1,800, at 15% per annum.

8. Two office desks purchased for cash at $55 each were disposed of for $40, which amount was credited to Office Equipment account.

Required:

Adjustment journal entries to record the foregoing items.

QUESTIONS FOR DISCUSSION

1. Why is it necessary to record the amount of interest and other expenses incurred but not paid at the time of making up the financial statements at the close of the fiscal period?

2. What accounts are affected by the adjustment of items in (1)?

3. How do Accrued Expenses differ from Accrued Income?

4. Deferred Income items and Accrued Expense items are both liabilities. Compare the two.

5. A rent item may be either a deferred charge, a deferred income, an accrued income, or an accrued expense. How is this possible?

6. What effect have the adjustments due to accrued expenses upon the profit and loss statement; the balance sheet?

7. Taxes are sometimes assessed in April and are payable in October, making the tax year extend from March 31 to April 1. How will this affect the adjustment of tax items for a concern having a fiscal year ending December 31?

8. What is the purpose of entries made after the books are closed to reverse the adjustment entries?

9. State the advantages and disadvantages in using detailed accounts with various items adjusted, instead of the one account, Miscellaneous Expenses Accrued.

10. In adjusting the following items at the close of the fiscal period, state what accounts will be affected: buildings, accounts receivable, insurance unexpired, office supplies on hand, interest earned on bonds owned, wages due workmen, rent paid in advance by a tenant.

SUMMARY OF CHAPTERS X AND XI

The *Cash Basis* of keeping books includes as income and expenses all amounts *received* and *paid* whether applicable to the current period or not. The *Accrual Basis* adds to the income all *income earned* and charges to expense all *expenses incurred* for the current period, regardless of when collected or paid. The Accrual basis makes it possible to find the correct profit or loss for the current period; the Cash basis does not.

Income *earned* during the period and not recorded is entered on the books by debiting some related asset account and crediting the income account. The expenses *consumed* during the period and not recorded are likewise entered on the books by debiting an expense account and crediting the related liability account. Since accrued income *increases* the assets and, therefore, *increases* the profit for any given period, the amount representing such accrued income is shown in the balance sheet, usually under "current assets," and also in the profit and loss statement, usually under "other income." Since accrued expenses *increase* the liabilities and, therefore, *diminish* the profit for any given period, the amount representing such accrued expenses is shown in the balance sheet, usually under "current liabilities," and also in the profit and loss statement, usually under "operating expenses."

CHAPTER XII

MISCELLANEOUS ADJUSTMENTS

Analysis of Mixed Accounts. — The balance of each account in the ledger should represent either an asset, a liability, a capital, an expense or an income item. Mixed accounts, or accounts containing more than one of these elements, are sometimes used for convenience in recording transactions, especially in a small business. To adjust mixed accounts, either to secure data in proper form for the financial statements, or to eliminate such accounts entirely, an analysis of the account is made in order to determine what information has been entered therein. In order to analyze the account properly it is often necessary to trace each entry to the journals. An entry is then made to close the mixed account and substitute for it the proper accounts. Accounts of this nature requiring adjustment are Interest and Discount, Merchandise Discount, Real Estate, Merchandise, etc.

Illustration No. 1

Interest and Discount. — When this account is used, it contains both expense and income items, the account being charged with interest expenses of various kinds and credited with interest income. For example, an Interest and Discount account shows a debit balance of $15. An analysis of the account shows the debits to consist of interest on notes payable, $35; and discount on notes receivable, $42. The credits consist of interest on notes receivable, $62. The following entry is made to adjust the account:

Interest Expense	$77.00	
Interest Income		$62.00
Interest and Discount		15.00
To close Interest and Discount account and set up accounts with expense and income.		

Illustration No. 2

Merchandise Discount. — This account is debited with discounts allowed on sales and credited with discounts received on purchases. For example, a Merchandise Discount account shows a debit balance of $98. An analysis of the account shows sales discounts, $278, and purchase discounts, $180. The entry to adjust follows:

Sales Discount	$278.00	
Purchases Discount		$180.00
Merchandise Discount		98.00

The accounts in the foregoing illustrations are closed into Profit and Loss account in the ledger at the close of the period and appear in the profit and loss statement as Other Income and Other Expense. They do not appear in the balance sheet.

Analysis of Expense Accounts. — The use of a General Expense account to which all expense items are charged gives the management little information as to the various kinds of expenses. It, therefore, becomes necessary to analyze such accounts when making up the financial statements. Any group expense account may be analyzed and detailed accounts substituted as desired by the owners of the business. Examples of such accounts are General Expense, Selling Expenses, Delivery Expenses, Maintenance of Real Estate, etc.

For example, General Expense account shows a debit balance of $7,252. An analysis of the account shows the following: salaries and wages, $6,000; advertising, $800; office supplies, $52; taxes, $326; insurance, $74. If it is desired to use detailed expense accounts, the following entry is made:

Salaries and Wages	$6,000.00	
Advertising	800.00	
Office Supplies	52.00	
Taxes	326.00	
Insurance	74.00	
General Expense		$7,252.00
To close General Expense account and open detailed accounts with expenses.		

The same principle may be applied to any expense account.

Distribution of Expense Accounts. — It is often more convenient to record certain types of expenses in general accounts during the period and then distribute them at the close of the period to departments or to other expense accounts as may seem most desirable. A common example of this kind of transfer is the Payroll account to which is charged the weekly or monthly payroll, which is then analyzed at the close of the period and charged to the proper accounts. For example, if the total payroll for a month is $4,300 and an analysis shows it to be made up of salesmen's salaries, $1,800; general office salaries, $1,500; delivery clerks' salaries, $1,000; the entry to adjust is as follows:

Salesmen's Salaries	$1,800.00	
Office Salaries	1,500.00	
Delivery Expenses	1,000.00	
Payroll		$4,300.00
To distribute Payroll account to proper expense accounts.		

After making this entry the Payroll account is closed and the detailed accounts appear in place thereof.

Correction of Bookkeeping Entries. — The bookkeeper sometimes makes an incorrect classification of accounts at the time of recording a transaction, such as debiting or crediting the improper account. Faulty classification in bookkeeping results in grouping miscellaneous items into accounts which must be analyzed and redistributed in order to show the correct condition of the business. The only adjustment involved is that of transferring the items to the proper accounts. For instance, assume that automobile tires costing $36 are charged to the Delivery Equipment account. The entry to correct is as follows:

Delivery Expenses	$36.00	
Delivery Equipment		$36.00
To transfer cost of tires to expense account.		

EXERCISE 12-a

A Real Estate account shows a debit balance of $13,000. An analysis of the account shows that the debits consist of cost of property at 75 Bonwood Street, $12,500, the building being valued at $10,000 and the lot at $2,500; improvements to the building, $900; repairs, $600. The credit consists of an item of $1,000 representing the sales price of part of the lot sold, the cost price of which was $750.

Required:

Journal entry to eliminate the Real Estate account and substitute proper detailed accounts in its place.

EXERCISE 12-b

The firm of Roberts and Rice using a mixed Merchandise account wishes to discontinue the same and substitute detailed ledger accounts. An analysis of the debit side of the Merchandise account shows purchases, $60,000; returns to the firm, $4,000; entries offsetting errors in sales extensions, $2,000; allowances to customers, $3,500; balance, gross profit, $27,000. The credit side shows sales, $80,000; returns by the firm, $5,000; allowances to the firm, $1,500; inventory at close of year, $10,000.

Required:

Journal entry to close Merchandise account and substitute detailed ledger accounts.

EXERCISE 12-c

The balance of an Interest and Discount account is $81.60. The account is made up of the following items:

Interest on notes payable	$ 28.13
Interest on notes receivable	35.80
Discount on notes receivable	63.40
Discount on notes payable	20.00
Discount on sales	325.67
Discount on purchases	319.80

Required:

Prepare entry to set up accounts with Interest Expense, Interest Income, Sales Discount, and Purchases Discount.

EXERCISE 12-d

(1) Freight Inward amounting to $1,420 is to be distributed to the departmental purchase accounts according to the volume of purchases for the period. The purchases were as follows: Men's Shoes, $12,150; Women's Shoes, $18,240; Children's Shoes, $5,240.

(2) Delivery expenses for the fiscal period amount to $1,820. Three-fifths of this amount is to be charged to Purchases account and two-fifths to Selling Expenses.

(3) The total cost of maintaining the property for the year amounting to $2,684 has been charged to Maintenance of Real Estate account. This is to be distributed to the various departments on the basis of floor space occupied by each as follows: sales department 60%; shipping department 8%; purchase department 12%; general office 20%.

(4) Insurance premiums were charged to Insurance Expense account, $460. Of this amount $120 was prepaid at the close of the fiscal period. The used portion of the insurance is charged as follows: 40% to Selling Expenses; 30% to Delivery Expenses; 10% to General Administrative Expenses; and the remainder to Building Expense.

(5) A building costing $60,000 is estimated to last 40 years. Set aside depreciation for one year, 60% of the building being used for sales offices and the remainder for general offices.

Required:

Journal entries to adjust and distribute each of the above items to the proper account.

EXERCISE 12-e

(1) J. B. Sanders, a customer, has failed in business and his account amounting to $268.20 is a total loss. The bookkeeper charged the loss to Selling Expenses.

(2) A bill for repairs to auto trucks amounting to $225 has been charged to Delivery Equipment.

(3) The bookkeeper charged the account of R. G. Graves with check for $750 issued to him to pay the firm's 30-day note in his favor. Controlling accounts are kept with Accounts Receivable and Accounts Payable.

(4) A note of E. E. Merville, a customer, amounting to $250 was discounted at the bank for 60 days at 8%, the discount being charged to Selling Expenses.

(5) A bill for repairs to store building amounting to $1,250 and another for shipping supplies amounting to $85.60 were recorded in the Purchases Journal by the bookkeeper and included in the charge to Merchandise Purchases at the end of the period.

Required:

Make proper journal entries to correct the ledger accounts affected by the foregoing items.

QUESTIONS FOR DISCUSSION

1. What is the objection to the use of mixed accounts, such as Merchandise, Real Estate, Interest and Discount, etc.?

2. Outline in some detail the procedure necessary to eliminate mixed accounts.

3. Is it always necessary to open detailed accounts in the ledger in order to secure an analysis of expenses for the financial statements?

4. Why are certain types of expenses charged to general expense accounts as paid and later distributed to departmental expense accounts instead of being so distributed when paid?

5. Name the usual basis for distributing the following items to departments when it is desired to show net profit by departments: rent, payroll, freight inward, freight outward, insurance.

6. How are errors in classifying business transactions adjusted at the close of the period?

CHAPTER XIII

TRADING ITEMS

Nature and Purpose. — Business concerns may be divided into two classes — *manufacturing* and *trading*. The manufacturer buys raw material, converts it into finished product and sells it to the trader or merchant. The trader buys the finished product from the manufacturer and sells or distributes it to the consumer.

The accounts used for the purpose of recording the merchandising activities of the trader, and from which his *gross profit* or *loss* is determined, are known as *trading* accounts. The trading group consists of the following accounts: Merchandise Inventory, Purchases, Sales, Freight Inward, Purchases Returns and Allowances, Sales Returns and Allowances, and under certain conditions Purchasing Expenses, Sales Discounts, Purchases Discount, and Freight Outward.

Trading Items in the Profit and Loss Statement. — The first section of the profit and loss statement is known as the trading section and includes those trading items that are necessary to determine the gross profit for the period. A convenient arrangement of the items is as follows:

JOHN TAYLOR

Profit and Loss Statement for the Year Ending June 30, 19--

				Per Cent of Sales
Gross Sales		$35,220.00		
Less--Returns and Allowances		270.00		
Net Sales			$34,950.00	100.00
Deduct--Cost of Goods Sold:				
Inventory July 1, 19--		$8,500.00		
Gross Purchases	$19,540.00			
Less--Returns and Allowances	640.00			
Net Purchases		18,900.00		
Freight and Cartage Inward		800.00		
Total Cost of Goods		$28,200.00		
Less--Inventory June 30, 19--		7,600.00		
Cost of Goods Sold			20,600.00	58.94
Gross Trading Profit (69.66% on Cost of Sales)			$14,350.00	41.06

Percentages Applied to Trading Items. — The rate of gross profit realized on the volume of business done is of great value to the merchant. The profit may be reckoned as a certain per cent of the *cost of goods sold* or of the *net sales*. It is often figured on sales as sales figures are available at all

times while the cost of sales is computed only at the end of the fiscal period. The business man likes to know what proportion of his sales is applied to cost of goods sold and to expenses and what part remains as profit. By using the sales basis in the statement at the end of a period a rate is established which he can apply to his sales from day to day during the ensuing period and use as a guide in the conduct of his business. Either basis is a valuable guide to the business man if adhered to consistently.

To find the rate of gross profit on sales, the gross profit is divided by the net sales. To find the gross profit on cost of sales, the gross profit is divided by the cost of goods sold. In the illustration, page 100, the gross trading profit, $14,350, divided by cost of sales, $20,600, gives 69.66% of cost, while $14,350 divided by net sales, $34,950, gives 41.06% of net sales.

Merchandise Turnover and Method of Calculating. — If goods remain in stock one year, the capital invested therein can be used only once during that period. If the profit on sales is 10%, only 10% can be earned in a year's time on the amount invested. However, if the goods remain in stock but six months, the capital can be " turned over " or reinvested in additional goods at the end of the six months. If, therefore, the rate of profit on sales continues to be 10%, the profit on the amount invested for the year will be 20%. The more rapidly stock can be turned over, the greater the return on a given investment. The term *turnover* refers to the total cost of goods sold during the fiscal period. The number of times the stock has been turned, or the *rate of turnover*, may be found by dividing the *cost of goods sold* by the *average inventory*. The average inventory is found by dividing by two the sum of the inventories at the beginning and end of the fiscal period. If the inventories at the end of each month are available, it is better to add those and divide by twelve. In the illustration, page 100, turnover is figured as follows:

Cost of Goods Sold	$20,600.00
Inventory July 1, 19—	8,500.00
Inventory June 30, 19— (the following year)	7,600.00
Average Inventory	8,050.00

$20,600 ÷ $8,050 gives 2.55, the rate of turnover for the year.

The same result may be obtained by using the sales and the selling prices of the inventories instead of the above items.

Trading Account in the Ledger. — To bring the trading items together in the ledger as they appear in the trading section of the profit and loss statement, they are transferred to a summary account in the ledger known as the

Trading account. The balance of this account shows the *gross trading profit* which agrees with the amount shown in the profit and loss statement. The Trading account in the ledger, therefore, appears as follows:

Trading

1928				1928			
June 30	Inv. 7/1/27	8500 00		June 30	Net Sales		34950 00
30	Net Purchases	18900 00		30	Inv. 6/30/28		7600 00
30	Freight In	800 00					
30	Gross Profit	14350 00					
		42550 00					42550 00

The balance of this account is transferred to Profit and Loss account at the end of the period.

In the closing process it is usually better practice to close the Sales Returns account into Sales and the Purchases Returns account into Purchases, but these accounts may be transferred directly to the Trading account if desired.

Determining the Amount of Inventory at the End of the Fiscal Period. — (a) *Physical Inventory Method.* This method consists of listing all the goods on hand at the close of the period by actual count and pricing them at original cost or market price whichever is lower, and adding to this price the proportion of freight and purchasing expenses applicable to the goods on hand. The various goods on hand are listed on inventory sheets or cards. A form similar to the following may be used:

INVENTORY OF Linoleum No. 2-a

Department Floor Coverings Page 1

Taken by K.O.B. Extended by E.B.P

Priced by P.E.H. Added by K.D.C.

Checked by N.A.M. On Hand June 30, 19-- Approved by L.O.R.

✓	Quantity	Unit	Description	Price	Amount	Total
	500	yds.	Cork Linoleum #15	1.45	725 00	
	350	"	" " #16	1.65	577 50	

(b) *Book or Perpetual Inventory Method.* A book inventory is one kept in such a manner as to make it possible to determine the value of goods on hand at any time without the necessity of taking an actual count of them. It generally consists of a loose-leaf ledger sheet or card for each article carried. The following is a simple form of such record:

STOCK RECORD CARD

Minimum 100 Location Third section--right

Maximum 1000 Unit yard Article Linoleum #15

Date	Received			Delivered			Balance		
	Quantity	Rate	Amount	Quantity	Rate	Amount	Quantity	Rate	Amount
19--									
June 2	750	1.50	1125 00	100	1.50	150 00	650	1.50	975 00
3				500	1.50	750 00	150	1.50	225 00
10				150	1.50	225 00			
15	500	1.45	725 00	100	1.45	145 00	400	1.45	580 00

When goods are received, they are entered in the Received columns at *cost;* as these goods are sold, entries are made in the Delivered columns at *cost* and the balance extended at *cost.* The total of the balances of all stock record cards gives the inventory at *cost* price at any time.

(c) *Costing the Sales Method.* This consists of using a duplicate sales invoice containing two money columns — one for the *sales* price and the other for the *cost* price. After the bill has been made out and the original sent to the customer, the *cost* of the goods is extended on the duplicate invoice as shown below:

DUPLICATE SALES INVOICE

To The Marsh Co., Date June 3, 19--

Cleveland, Ohio

Quantity	Article	Price	Amount	Cost	
				Price	Amount
100 yds.	Linoleum #15	2.25	225 00	1.50	150 00

The cost figures as shown by the duplicate invoices are then added to get the total cost of goods sold. The total cost of sales deducted from the sum of the purchases during the period plus the inventory at the beginning of the period gives the value of the inventory at the close of the period.

(d) *Percentage or Mark-up Method.* An estimated per cent is added to the first cost to cover expense and profit. This is known as the *mark-up*. To find the cost of goods sold when the mark-up is known the selling price is divided by one hundred per cent plus the *mark-up* per cent. The cost of goods sold is deducted from the sum of the purchases plus the inventory at the beginning of the period to find the inventory at the end of the period, as in the costing the sales method. For example, if goods are sold for $22,500, the average mark-up being 50%, then $22,500 represents 150% of the cost. $22,500 divided by 150% gives $15,000, cost of sales. Assuming inventory at beginning of period to be $5,000 and purchases for the period $18,000, the inventory is found as follows:

Inventory at beginning of period	$ 5,000.00
Purchases for period	18,000.00
Total cost of goods	$23,000.00
Cost of sales deducted	15,000.00
Inventory at close of period	$ 8,000.00

The physical inventory is always best and should be taken at least once a year to prove the inventories when kept by any of the other methods. A book inventory has many advantages when the expense of keeping the same is not too much. It makes possible the preparation of financial statements without taking a physical inventory. The cost of sales and percentage methods cannot be proved until a physical inventory is taken. The percentage method gives averages only, so that it is necessary to adjust the figures frequently.

Methods of Handling Inventory Accounts in the Ledger. — There are two methods of handling the inventory accounts at the close of the fiscal period known as the *adjustment* method and the *closing* method. Under the adjustment method the inventory at the beginning of the period is adjusted so as to bring the same into agreement with the amount of the inventory at the close of the period. If the new inventory is larger than the old inventory, the inventory account is debited for the difference and Purchases or Trading account credited for this amount. If the new inventory is smaller than the old inventory the entry is reversed. Under this method the inventory account for the items appearing in illustration on page 100 is as follows:

Merchandise Inventory

1927						1928					
July	1	(old inv.)	8500	00		June	30	To adjust		900	00
							30	Balance		7600	00
			8500	00						8500	00
1928											
July	1	(new inv.)	7600	00							

Under the closing method the old inventory is closed into Purchases or Trading account and the new inventory is charged to the inventory account and credited to Purchases or Trading. The ledger account under this method appears thus:

Merchandise Inventory

1927						1928					
July	1	(old inv.)	8500	00		June	30	To Trading		8500	00
1928											
June	30	(new inv.)	7600	00							

Reference to Trading account on page 102 shows that the closing method was used at the time that account was set up. Under most conditions the closing method is preferred as it is logical and gives the items as they are handled in the profit and loss statement. Both inventories appear in the profit and loss statement, while only the new inventory at the close of the period appears in the balance sheet.

EXERCISE 13-a

January 1, 19— the inventory of goods in the warehouse amounted to $96,850. During the year purchases amounted to $280,475. On December 31, 19— the inventory of goods on hand amounted to $110,430. Find the amount of gross sales. The gross profits were $98,200 and returned sales amounted to $12,400.

Required:

(*a*) Prepare the trading section of a profit and loss statement showing gross profit on sales.

(*b*) The turnover for the period.

(*c*) The number of times the stock was turned.

(*d*) Find rate of gross profit on net sales.

(*e*) Find rate of gross profit on cost of sales.

EXERCISE 13-b

The books of a trading enterprise contain the following items:

Inventory January 1, 19—	$ 62,480.00
Gross purchases for the year	192,650.00
Purchase returns and allowances	1,450.00
Gross sales for the year	228,560.00
Sales returns	2,460.00
Freight inward	2,680.00
Inventory December 31, 19—	54,620.00

Required:

(*a*) The trading section of a profit and loss statement.
(*b*) The rate of turnover for the period.
(*c*) The rate of gross profit on net sales.
(*d*) The rate of gross profit on cost of sales.

EXERCISE 13-c

The inventory on December 31, 1926 including a charge for freight inward amounted to $250,000. The net purchases during the ensuing year amounted to $490,000. The freight inward for the same period amounted to $7,350. On December 31, 1927 the invoice price of goods on hand exclusive of any freight charges amounted to $236,000.

Required:

The amount of the freight inward charge to be added to the inventory of December 31, 1927, as part of its value.

EXERCISE 13-d

The following trading items are taken from the books of the Jamaica Department Store:

Inventory in Department A, January 1, 19—	$12,420.00
Purchases during the month of January	1,880.00
Sales for the month	6,880.00
The "mark-up" on the goods is 60%.	

Required:

(*a*) The cost of the goods sold.
(*b*) The value of the inventory, January 31.
(*c*) The gross profit on sales.
(*d*) The rate of gross profit on cost of sales.

EXERCISE 13-e

The balance sheet of R. Whitworth & Co., wholesale dealers in wool, on December 31, 19— shows, among other items, the following balances: Inventory, $17,500; Accounts Receivable, $14,500; Accounts Payable, $21,000. During the next three

months their cash records show receipts from customers, $56,325; payment to creditors, $46,005; cash discounts allowed to customers, $2,650; cash discounts taken on payments, $2,000. The inventory on March 31, 19— is $26,350; balance due from customers, $18,500; balance due creditors, $24,345.

Required:

Prepare statements showing the purchases, sales, and gross profit on sales for the period.

QUESTIONS FOR DISCUSSION

1. What is a trading account and what items are included in the same?
2. Of what value to a merchant are percentage statistics regarding volume of sales?
3. Should gross profit be figured on sales or on cost of sales? Explain.
4. What is meant by "turnover" and how is it calculated?
5. Why is a rapid turnover desirable from the standpoint of the management?
6. Outline three methods of finding the value of merchandise inventory at the close of the fiscal period.
7. Explain the difference between a Trading account and a Profit and Loss account.
8. How does a book inventory differ from a physical inventory?
9. Why is a book inventory called a *perpetual* inventory?
10. Are all book inventories perpetual inventories?
11. Explain the "costing the sales" method of figuring inventory. What determines the accuracy of this method?
12. What is meant by the "mark-up" method and how is the mark-up rate determined?
13. Explain the two methods of adjusting the inventory account in the ledger at the end of the period.
14. The average gross profit for a certain business has been 35% when a fire occurs. If book inventories are not kept, state how the value of the inventory at the time of the fire can be ascertained, in order to file a claim with the insurance company.

CHAPTER XIV

PERIODIC GENERAL LEDGER WORK

Nature and Purpose. — In order to bring the real accounts in the ledger into agreement with the items as shown by the balance sheet and prepare the nominal accounts to receive the items for the next period, it is necessary to adjust and close the ledger at the end of the fiscal period. This periodic ledger work is accomplished by means of adjusting and closing entries. The adjusting entries correct the various accounts as follows: (1) by bringing into the ledger those assets and liabilities that have accrued but are not recorded; (2) by separating mixed accounts into their *real* and *nominal* elements; and (3) by making such other transfers as may be necessary to have the accounts show correct results. The closing journal entries when posted balance all *nominal* accounts by transferring them to the Profit and Loss account. From the Profit and Loss account the net profit or net loss is distributed to the Capital accounts. The various *nominal* accounts are then ruled to close them and the balances of the *real* accounts in the ledger agree with the balance sheet items. Therefore, at the beginning of a fiscal period, the ledger contains open accounts with assets, liabilities, and capital only; during the period nominal accounts with expense and income are used to show *sources* of increase and decrease in capital. At the close of the period the nominal accounts are transferred through the Profit and Loss account to the Capital account and again the only open accounts in the ledger are the real accounts.

The Adjusted Trial Balance. — The totals from the various journals are posted at the end of each month; the journals are then ruled and closed. A trial balance is then taken in order to test the accuracy of the posting and see if the ledger is in balance. The trial balance taken at the end of the fiscal period is the one used as a basis for the closing process. This trial balance contains not only asset, liability, capital, expense and income accounts but also mixed accounts; it does not reveal the assets and liabilities that have accrued but have not been recorded. Such a trial balance taken from month to month and at the end of the fiscal period to test the accuracy of posting is known as the *current* or *preliminary* trial balance; it is sometimes referred to as the *trial balance before adjusting*. After taking the trial balance, adjustment journal entries are made to record those assets and liabilities which have accrued and which have not been entered, and to separate the real and nominal

elements in the mixed accounts as shown by the current trial balance. Each item in the current trial balance must be examined to see if it needs correcting in any way.

After the adjustment journal entries have been posted, a second trial balance is taken which is known as the *adjusted trial balance*. This trial balance not only proves that the accounts are in balance, but it furnishes a corrected list of all items to be included in the financial statements. It contains real and nominal accounts only, the real accounts to be set up in the form of a balance sheet and the nominal accounts in the form of a profit and loss statement. After the closing process has been completed and the nominal accounts in the ledger ruled, a third trial balance is taken of the real accounts to see that the ledger is still in balance. This trial balance is known as a *post-closing trial balance*.

Procedure for Monthly Statements. — It is customary to take a current trial balance each month and to prepare an adjusted trial balance only at the time the financial statements are prepared. It is sometimes advantageous to prepare financial statements also at the end of each month but not to close the ledger, however, until the end of the fiscal period. In such cases the adjustment journal entries are not posted to the ledger but are transferred to an analysis sheet, sometimes referred to as a *working trial balance*. The working trial balance contains the current trial balance, the adjustments, and the corrected figures, or adjusted trial balance, from which the statements are prepared. The adjustments made at the end of the fiscal period are posted and the ledger closed as usual. It is inexpedient to close the ledger each month when statements are desired, not only because of the extra clerical work involved but because it tends to destroy the statistical value of the ledger accounts.

Analysis of the Adjusted Trial Balance. — The adjusted trial balance forms the basis for the preparation of the financial statements, the *real* accounts being included in the balance sheet and the *nominal* accounts in the profit and loss statement. Before preparing the statements in standard form, it is advisable to go through the trial balance and indicate in some way where the accounts are to appear in the statements. This analysis makes it easier to prepare the statements and also prevents the omission of any items from the various sections of the statement as they are being set up in proper form.

One method of designating the classification of each item in the trial balance is to write in front of the item a symbol, viz., " ca " for current assets; " fa " for fixed assets; " dc " for deferred charges; " t " for trading; " oe " for operating expenses; " oc " for other charges; " c " for capital; etc., as follows:

JOHN TAYLOR

Adjusted Trial Balance, June 30, 19--

fa	Store Equipment	3000 00	
fa	Office Equipment	1050 00	
fa	Delivery Equipment	2250 00	
ca	Cash	5900 00	
ca	Accounts Receivable	28751 00	
ca	Notes Receivable	500 00	
t	Inventory	8500 00	
dc	Insurance Prepaid	154 00	
cl	Accounts Payable		14375 00
cl	Notes Payable		1000 00
c	John Taylor, Capital		25000 00
t	Purchases	19540 00	
t	Purchase Returns and Allow.		640 00
t	Sales		35220 00
t	Sales Returns and Allow.	270 00	
t	Freight and Cartage Inward	800 00	
oe	Selling Expense	1950 00	
oe	Delivery Expense	1080 00	
oe	General Administrative Exp.	2650 00	
oi	Purchases Discount		720 00
oc	Interest Expense	175 00	
oi	Interest Income		95 00
oc	Sales Discount	480 00	
		77050 00	77050 00

Another method of analyzing the trial balance preparatory to setting up the statements in finished form is by use of an analysis sheet known as a *working trial balance* or *work sheet*. The form shown on page 111 shows an analysis of John Taylor's trial balance by means of an eight-column work sheet. The work sheet usually contains no fewer than six columns, and it may contain as many more as the details of analysis require. When six columns are used the trading columns are omitted, those items being included in the expense and income columns. When the *books are to be closed*, the only purpose of the work sheet is to prove the arithmetical results of the financial statements and list the items in convenient form for the closing entries and for the preparation of the statements. When the books are not to be closed, as when monthly statements are desired, some form of analysis or work sheet is not only very desirable but necessary for setting up adjustments, analyzing the accounts, etc. A more complex form and a detailed explanation of the work sheet is found on pages 140 and 141.

JOHN TAYLOR

WORK SHEET JUNE 30, 19—

Accounts	Trial Balance		Trading		Profit and Loss		Balance Sheet	
	Dr.	Cr.	Charges	Credits	Expenses	Income	Assets	Liabilities and Capital
Store Equipment	3000 00						3000 00	
Office Equipment	1050 00						1050 00	
Delivery Equipment	2250 00						2250 00	
Cash	5900 00						5900 00	
Accounts Receivable	28751 00						28751 00	
Notes Receivable	500 00						500 00	
Inventory	8500 00		8500 00	7600 00			7600 00	
Insurance Prepaid	154 00						154 00	
Accounts Payable		14375 00						14375 00
Notes Payable		1000 00						1000 00
John Taylor, Capital		25000 00						25000 00
Purchases	19540 00		19540 00					
Purchase Returns and Allow.		640 00		640 00				
Sales		35220 00		35220 00				
Sales Returns and Allow.	270 00		270 00					
Freight and Cartage In.	800 00		800 00					
Selling Expense	1950 00				1950 00			
Delivery Expense	1080 00				1080 00			
Gen'l Administrative Exp.	2650 00				2650 00			
Purchases Discount		720 00				720 00		
Interest Expense	175 00				175 00			
Interest Income		95 00				95 00		
Sales Discount	480 00				480 00			
	77050 00	77050 00						
Gross Profit on Sales			14350 00			14350 00		
			43460 00	43460 00				
Net Profit for the Year					8830 00			8830 00
					15165 00	15165 00	49205 00	49205 00

Inventory June 30, 19—, $7,600

Illustration — Eight-Column Work Sheet

Closing Journal Entries. — There are two common methods of setting up the closing journal entries for the *trading items* in the ledger known as the *Cost of Sales* and the *Trading* methods. In the *Cost of Sales* method the inventory at the beginning of the period is transferred to Purchases account. The inventory at the end of the period is then charged to the Inventory account and credited to Purchases account. After transferring Purchase Returns, Freight Inward, and Purchasing Expenses, if any, to the Purchases account its balance shows the cost of goods sold. This balance is charged to Sales account and credited to Purchases account, closing the same. The balance of Sales account now represents the gross trading profit which is transferred to the Profit and Loss account.

In the *Trading* method of closing, Sales Returns and Purchase Returns are closed into Sales and Purchases accounts respectively, and all other trading items are closed into a *Trading* account. The inventory at the close of the period is charged to the Inventory account and credited to the Trading account. The balance of Trading account then represents the gross trading profit and is transferred to the Profit and Loss account. The entries for transferring the various expense and income accounts to Profit and Loss are the *same under both methods.*

Journal entries to close trading accounts of John Taylor using the Trading method are as follows:

Sales	$270.00	
Sales Returns and Allowances		$270.00
To transfer sales returns to Sales account.		
Sales	34,950.00	
Trading		34,950.00
To transfer net sales to Trading account.		
Trading	8,500.00	
Merchandise Inventory		8,500.00
To transfer inventory July 1 to Trading account.		
Purchase Returns and Allowances	640.00	
Purchases		640.00
To transfer purchase returns and allowances to Purchases account.		
Trading	18,900.00	
Purchases		18,900.00
To transfer net purchases to Trading account.		

Trading	$ 800.00	
Freight and Cartage Inward		$ 800.00
To transfer freight on purchases to Trading account.		
Merchandise Inventory	7,600.00	
Trading		7,600.00
To set up as an asset inventory June 30.		
Trading	14,350.00	
Profit and Loss		14,350.00
To transfer gross trading profit for the year to Profit and Loss account.		

The closing entries should be made in the same order in which the items appear in the profit and loss statement. The foregoing entries follow the order of the items in the trading section of John Taylor's statement on page 100.

EXERCISE 14-a

Frank Harris

Trial Balance, December 31, 19—

Cash	$ 4,890.22	
Accounts Receivable	3,560.78	
Notes Receivable	1,200.00	
Merchandise Inventory, December 1	2,983.17	
Insurance Prepaid	360.00	
Stamps and Stationery on hand	120.00	
Investments	1,000.00	
Real Estate	10,000.00	
Accounts Payable		$ 3,892.71
Notes Payable		1,890.00
Mortgages Payable		6,500.00
Frank Harris, Capital		12,390.77
Purchases (and returns)	8,489.60	241.18
Sales (and returns)	241.70	13,999.45
Freight Inward	1,216.11	
General Administrative Expenses	1,630.00	
Purchasing Expenses	952.80	
Selling Expenses	1,841.96	
Maintenance of Real Estate	320.40	
Purchases Discount		171.90
Interest Income		10.87
Sales Discount	240.08	
Interest Expense	50.06	
	$39,096.88	$39,096.88

The value of merchandise on hand December 31, 19— is $6,860.

Required:

(*a*) Open ledger accounts with all trading, expense, income and capital items in the foregoing trial balance. (The asset and liability items may be omitted as they are not used in the closing process.) Insert balances under date of December 31, 19—.

(*b*) Prepare closing journal entries. Transfer the merchandising items to a Trading account, which in turn will be closed into Profit and Loss account.

(*c*) Post the closing journal entries, make proper notations in the ledger, and rule up the accounts.

(*d*) Copy the foregoing trial balance on an eight-column work sheet, using form shown on page 111, extend the items, and find the net profit.

EXERCISE 14-b

A. J. Carpenter

Profit and Loss Statement for Year Ending June 30, 1927

Gross Sales		$760,940.60	
Less — Returns and Allowances		15,820.30	
Net Sales			$745,120.30
Deduct — Cost of Goods Sold:			
Inventory June 30, 1926		$ 85,416.60	
Gross Purchases	$598,210.25		
Less — Returns and Allowances	15,420.00	582,790.25	
Freight Inward		5,420.10	
Total Cost of Goods		$673,626.95	
Less — Inventory June 30, 1927		68,452.05	605,174.90
Gross Trading Profit			$139,945.40
Deduct — Operating Expenses:			
General Administrative Expenses		$ 45,360.10	
Selling Expenses		30,269.45	
Delivery Expenses		14,485.25	90,114.80
Net Trading Profit			$49,830.60
Add — Other Income:			
Purchases Discount		$ 2,112.30	
Interest Income		520.00	2,632.30
Total Income			$52,462.90
Deduct — Other Charges:			
Provision for Doubtful Accounts		$ 1,540.10	
Sales Discount		850.40	
Interest Expense		350.00	2,740.50
Net Profit for the Year			$49,722.40

Required:

Using the above statement as a guide, prepare entries to close Carpenter's ledger on June 30, 19—. Make the entries in the order in which the various items appear in the statement, writing brief particulars for each entry. Use the Trading method for closing the merchandising items.

EXERCISE 14-c

C. J. Bannick

Profit and Loss Statement for the Year Ending September 30, 1927

Gross Sales		$165,225.00	
Less — Returns and Allowances		3,304.00	
Net Sales			$161,921.00
Deduct — Cost of Goods Sold:			
Inventory September 30, 1926		$ 8,106.00	
Gross Purchases	$151,450.00		
Less — Returns and Allowances	2,165.00		
Net Purchases		149,285.00	
Freight and Cartage In		2,820.00	
Total Cost of Goods		$160,211.00	
Less — Inventory September 30, 1927		9,875.00	150,336.00
Gross Trading Profit			$ 11,585.00
Deduct — Operating Expenses:			
Office Salaries		$ 3,718.00	
Rent		3,600.00	
Salaries of Salesmen		3,310.00	
Delivery Expense		1,949.25	
Advertising		924.50	
Traveling Expense		550.00	
Sundry General Expense		433.10	
Heating and Lighting		210.00	
Liability Insurance		195.00	
Postage		173.90	
Insurance on Stock and Fixtures		140.00	
Printing and Stationery		125.00	
Telephone and Telegrams		28.90	
Taxes		152.00	15,509.65
Net Trading Loss			$ 3,924.65
Add — Other Expenses:			
Sales Discount		$ 2,602.70	
Interest Expense		72.00	
Loss on Bad Accounts		84.38	
Cash Variance		2.55	2,761.63
Total Loss			$ 6,686.28
Deduct — Other Income:			
Purchases Discount		$ 2,910.25	
Sales of Junk		65.00	
Interest Income		14.70	2,989.95
Net Loss for the Year			$3,696.33

Required:

Closing journal entries based upon the above statement, using the Trading method of closing merchandise items. Set up the journal entries in the order in which the various items appear in the above statement.

EXERCISE 14-d

The Auto Supply Co.

Profit and Loss Statement, November 1, 1926 – October 31, 1927

Sales — spark plugs			$1,063,020.00	
Deduct — Cost of Sales:				
Inventory November 1, 1926	$ 34,320.00			
Purchases	852,819.00			
Freight	8,520.00	$895,659.00		
Less — Inventory October 31, 1927		50,400.00	845,259.00	
Gross Profit on spark plug sales				$217,761.00
Sales — automobile supplies			$ 137,595.00	
Deduct — Cost of Sales:				
Inventory	$ 22,450.00			
Purchases	119,240.00			
Freight	2,345.00	$144,035.00		
Less — Inventory October 31, 1927		19,200.00	124,835.00	
Gross Profit on automobile supply sales				12,760.00
Gross Trading Profit				$230,521.00
Deduct — Operating Expenses:				
Selling Expenses:				
Advertising		$25,500.00		
Delivery Expenses		8,065.00		
Salaries — salesmen		34,600.00		
Traveling Expenses		22,300.00	$ 90,465.00	
General Administrative Expenses:				
Directors' Fees		$ 2,500.00		
General Expenses		14,970.00		
Salaries — office and general		14,500.00	31,970.00	122,435.00
Net Operating Profit				$108,086.00
Deduct — Other Charges against income:				
Discounts on Sales			$ 12,200.00	
Interest on Bonds			12,500.00	
Provision for Doubtful Accounts			8,855.00	33,555.00
Net Profit				$74,531.00

Required:

Journal entries to close the accounts in the foregoing statement. Use Cost of Sales method of handling trading items.

QUESTIONS FOR DISCUSSION

1. Why is it necessary to close the ledger at the end of the fiscal period and what procedure is necessary to accomplish this?

2. Is it necessary or advisable to close the ledger each time financial statements are prepared?

3. How often should the journals be closed?

4. How many different kinds of trial balances are prepared and how do they differ in content?

5. What division is made of the accounts in the adjusted trial balance?

6. How are financial statements prepared monthly when the ledger is not closed until the end of the fiscal year?

7. Why is it not desirable to close the ledger monthly?

8. Outline two methods of analyzing the adjusted trial balance.

9. In what way does a work sheet assist in preparing financial statements?

10. When is some form of work sheet necessary?

11. Outline the chief differences between the Cost of Sales and the Trading method of closing the merchandising accounts.

12. Is it necessary to refer to the ledger in preparing the closing journal entries; if not, where is the data secured for the closing entries?

13. What should determine the order of the closing journal entries?

14. What is the condition of the accounts at the close of the periodic ledger work?

SUMMARY OF CHAPTERS XII-XIV

Mixed accounts are analyzed and classified in appropriate expense and income accounts, and an entry made debiting the expense accounts and crediting the income accounts and debiting or crediting the mixed account, as the case may be, to close it out.

General expense accounts are analyzed and classified according to the different kinds of expenses. An account is then debited for each class of expense and the general expense account is credited closing it out.

To save bookkeeping certain expenses are charged to group accounts as incurred and then distributed to the proper accounts at the close of the period. Payroll is the most important example of this type of adjustment.

Bookkeeping errors in classification are corrected by reversing the original entry in the incorrect account to cancel it, and then showing the correct entry in the proper account.

Trading accounts are those that record the merchandising activities of the business, such as purchases, sales, inventory, etc. The first section of the profit and loss statement is known as the trading section as it contains trading accounts only and shows the gross profit for the period. The Trading account in the ledger is an account to which are transferred all the detailed trading accounts at the close of the period. It contains the same items as the trading section of the profit and loss statement and shows the same result.

The inventory of goods on hand, for the purpose of preparing financial statements, may be found (1) by taking a *physical inventory* — listing and pricing goods

on hand at cost; (2) *Book Inventory* — keeping an account with each class of goods; (3) *Costing Sales* — finding cost of goods sold from total of duplicate invoices and deducting from total cost of goods purchased; (4) *Mark-up method* — adding estimated per cent of gross profit to one hundred per cent and dividing into total sales to find cost of sales, and deducting from total cost of goods purchased.

Inventory account in the ledger may be adjusted by debiting it for the increase in present inventory over the amount in the ledger or by crediting it for the decrease. A better method is to credit the Inventory account for the old inventory and debit it for the new inventory.

The ledger is closed and ruled at the end of the fiscal period to bring the accounts therein into agreement with the financial statements and prepare the accounts for the next period's business.

A *current trial balance* contains the balances of all accounts and tests the equilibrium of the ledger after posting. An *adjusted trial balance* is taken after all accounts have been corrected and mixed accounts eliminated. A *post-closing trial balance* is taken after the ledger is closed preparatory to starting the new period.

The *current trial balance* is used as a basis for the adjustment entries. The *adjusted trial balance* is the basis for the financial statements. The trial balance is analyzed and the classification indicated either by labeling the items in the trial balance or by setting up a *working trial balance*. The *work sheet* shows the accounts analyzed and extended into specific columns and proves the arithmetical results of the statements before they are set up in proper form.

Cost of Sales method of closing the ledger transfers all trading items to the Purchases account, which is in turn closed into Sales account and that account into Profit and Loss account.

Trading method of closing transfers all trading items including sales to the Trading account, which is in turn closed into Profit and Loss account. Expense and income items are closed into Profit and Loss account in the same manner under both methods.

After the ledger is closed the balances of the accounts agree with the items in the balance sheet.

ACCOUNTING PROCEDURE ILLUSTRATED

CHAPTER XV

ANALYSIS OF CURRENT TRIAL BALANCE

Purpose. — It is the purpose of this chapter and the chapters immediately following to present a model exercise worked out in detail illustrating the entire accounting procedure, beginning with the current trial balance and ending with the post-closing trial balance. The work sheet is used in place of the ledger as is done when monthly statements are desired. Closing and reversing entries are also presented so as to review all the principles presented in previous chapters. The student is urged to study the solution to the problem, paying particular attention to the form and arrangement of the statements and checking them with the comments and explanations regarding each part of the solution.

Steps in the Accounting Procedure. — At the end of the fiscal period, after the journals are ruled and posted, a trial balance is taken which includes the work for the entire period. Beginning with this trial balance there is a definite order in which the work should be completed.

The steps are as follows:

a Current trial balance

b Analysis of current trial balance for adjustment data

c Adjustment journal entries

d Adjustments posted to ledger or work sheet

e Adjusted trial balance

f Analysis of adjusted trial balance for statement data

g Balance sheet

h Profit and loss statement

i Closing journal entries

j Ledger work

k Reversing entries

l Post-closing trial balance.

Illustrated Problem

E. M. Harvey

Trial Balance, December 31, 1926

1	Cash	10250	90		
2	Accounts Receivable	14260	20		
3	Reserve for Doubtful Accounts			126	00
4	Notes Receivable	2550	00		
5	Inventory December 31, 1925	15825	02		
6	Land (Cost)	25000	00		
7	Building (Cost)	75000	00		
8	Reserve for Depr. of Building			12000	00
9	Office Equipment	5750	00		
10	Reserve for Depr. of Office Equip.			750	00
11	Warehouse Equipment	3410	00		
12	Reserve for Depr. of Warehouse Equip.			645	40
13	Delivery Equipment	2400	00		
14	Reserve for Depr. of Delivery Equip.			600	00
15	Investments (Bonds)	5000	00		
16	Insurance Prepaid	350	00		
17	Advances to Salesmen	210	00		
18	Mortgage Payable			26000	00
19	Accounts Payable			12290	45
20	Notes Payable			4000	00
21	E. M. Harvey, Capital			75000	00
22	E. M. Harvey, Current	5473	50		
23	Sales			180215	80
24	Sales Returns and Allowances	3840	30		
25	Purchases	98885	00		
26	Purchase Returns and Allowances			2260	20
27	Purchasing Expenses	530	60		
28	Freight and Hauling Inward	2460	00		
29	Traveling Expenses	5510	60		
30	Salaries and Wages	18920	50		
31	Warehouse Expenses	2410	00		
32	Advertising	6823	00		
33	Delivery Expenses	3835	10		
34	General Office Expenses	2627	40		
35	Real Estate Expense	2680	00		
36	Interest Expense	380	00		
37	Sales Discount	530	88		
38	Interest Income			123	10
39	Purchases Discount			752	05
40	Income from Investments			150	00
		314913	00	314913	00

In adjusting the accounts in the foregoing trial balance, preparatory to setting up the financial statements, the following items are to be taken into account:

(1) Merchandise Inventory:

Cost of goods on hand December 31, 1926	$18,234.20

(2) Accounts Receivable:

A customer's account amounting to $110 is considered worthless and is to be charged off the books, after which the Reserve for Doubtful Accounts is to be adjusted to equal 2% of the balance due from customers.

(3) Depreciation:

Building	2% per annum	$1500.00
Office Equipment	10% " "	575.00
Warehouse Equipment	10% " "	341.00
Delivery Equipment	20% " "	480.00

(4) Deferred Charges to Expense:

Insurance unexpired	$ 225.00
Advances to salesmen	75.00
Shipping supplies on hand	280.00
Office supplies on hand	72.00
Interest on notes payable	5.00

(5) Deferred Credits to Income:

Interest on notes receivable	$ 8.50
Rent paid in advance by tenant	25.00

(6) Accrued Income:

Interest on notes receivable	$ 9.20
Interest on bond investment	75.00

(7) Accrued Expense:

Interest on notes payable	$ 12.50
Salaries and wages	260.00
Interest on mortgage	780.00

(8) Miscellaneous Adjustments:

Freight on sales has been charged to Freight Inward	$124.00

Required:

(*a*) Adjustment journal entries covering data shown above
(*b*) Work sheet — 12 columns
(*c*) Balance sheet
(*d*) Profit and loss statement
(*e*) Closing journal entries
(*f*) Reversing entries
(*g*) Post-closing trial balance.

Analysis of the Current Trial Balance. — Mr. Harvey conducts a wholesale business in the building owned by him. A large part of the building is used for receiving, storing, and shipping goods; and the remaining space for general offices, a part of which is sublet to a friend of Mr. Harvey.

In order to find the correct profit or loss and to prepare accurate financial statements for a definite fiscal period, it is necessary to study all accounts in the trial balance, with the following aims: (1) to *eliminate* all mixed accounts; (2) to *include* all income and expense, whether paid or not, that belong to the fiscal period under consideration; (3) to *exclude* all income and expense items that belong properly to other fiscal periods. Each account should represent a *real* or *nominal* element and should show the correct amount. Accordingly, the accounts in Mr. Harvey's trial balance are now inspected and a list of the necessary adjustments compiled. The numbers to the left of the accounts in the trial balance correspond to the numbers of the accounts as found in the following paragraphs.

1. *Cash.* — This is an asset and, therefore, a real account. It represents the correct amount of money on hand and in bank and needs no adjustment.

2. *Accounts Receivable.* — This represents the total amount owing by customers. It is found that one of the customers who owes $110 has failed in business and his account is worthless. The Accounts Receivable account is, therefore, not stated at the correct amount and must be adjusted through the reserve account that has been provided for losses of this kind.

Experience shows that these accounts are never all collected in full, about 2% of the amount outstanding at the end of the year being uncollectible. The account, therefore, is in the nature of a mixed account, part of it being an asset that will be realized and part of it a loss that must be included in the expense of doing business. An adjustment of this account is, therefore, necessary to provide for this loss. As it is not known which accounts will not be collected the adjustment is made through a Reserve for Doubtful Accounts account.

3. *Reserve for Doubtful Accounts.* — This account measures the portion of the asset Accounts Receivable that it is estimated will not be collected. It is deducted from the Accounts Receivable account in order to find the real value of that asset and is, therefore, known as a *valuation* account. Reserve for Doubtful Accounts should be adjusted for the amount of the loss on account of the worthless account and also to increase the reserve to the amount that is estimated will prove uncollectible during the next fiscal period.

4. *Notes Receivable.* — This is a real account, and as the notes on hand are all considered good it needs no adjustment.

However, of the notes on hand, one for $1,000 is a renewed note on which interest was paid in advance. The unearned interest on this note amounts to $8.50. Other notes amounting to $1,250 bear interest at 6%. The accrued interest on these notes at this time amounts to $9.20. The Interest Income account will be adjusted to include these items.

5. *Merchandise Inventory December 31, 1925.* — This is a trading item representing the cost of goods on hand at the beginning of the year. It is a nominal account and requires no adjustment at this time. At the end of the year it is brought into agreement, through the closing entries, with the inventory at that time which is $18,234.20.

6. *Land.* — This is a real account and requires no adjustment. The market value of the land may change from time to time but the value should not be changed in the ledger until the land is disposed of.

7. *Building.* — It is estimated that the building has depreciated 2% during the year. This account, therefore, includes a nominal or expense element to the extent of $1,500. Adjustment is made through the Reserve for Depreciation account.

8. *Reserve for Depreciation of Building.* — This account measures the portion of the asset that has been consumed in the operation of the business and is deducted from the Building account to find the real value of that account. It is thus a valuation account and must be adjusted by adding to it the depreciation for the current year.

9–10, 11–12, 13–14. — These accounts are similar to 7–8 and are adjusted in the same manner.

15. *Investments (Bonds).* — This is a real account requiring no adjustment. The interest on these bonds at 6% is payable on April 1 and October 1. There is, therefore, three months' interest earned on these bonds at this time, amounting to $75, which must be brought into the accounts as an asset and as additional income.

16. *Insurance Prepaid.* — This account shows the amount of premiums paid in advance at the beginning of the year. It is now a mixed account, as the expired premiums for the year amount to $125, and is adjusted by transferring the nominal element to the proper expense account.

17. *Advances to Salesmen.* — This account shows the amount of expense money in the hands of salesmen at the beginning of the year. Expense reports have been received showing that all of this money with the exception of $75 has been expended. The account must, therefore, be adjusted by transferring the expended portion to the proper expense account.

18. *Mortgage Payable.* — This is a real account showing the true value of the mortgage given on land and building and, therefore, it needs no adjustment.

The interest on this mortgage at 6% is payable every six months, January 1 and July 1. As the last six months' interest, $780, has not been paid there is an accrued liability for that amount which must be brought into the accounts as additional expense.

19. *Accounts Payable.* — This represents the total amount owing to creditors. It is shown at the correct figure and is a real account requiring no adjustment.

20. *Notes Payable.* — This account contains a 60-day note for $1,000 discounted at the bank on December 1 at 6%, and sundry notes due creditors for $3,000. It is a real account stated at the correct amount and needs no adjustment.

Interest on the $1,000 note in favor of the bank was paid in advance on December 1. Only half of this interest has been earned; therefore, an asset of $5 must be brought into the accounts to decrease the expense by that amount. It is also found that notes to the amount of $1,500 owing to creditors are interest bearing, the amount of interest earned to date being $12.50. It is, therefore, necessary to increase the expense by bringing into the accounts an accrued liability for that amount.

21. *E. M. Harvey, Capital.* — This is a real account representing the investment in the business and requires no adjustment at this time.

22. *E. M. Harvey, Current.* — This is a real account representing the drawings during the year and needs no adjustment.

23, 24, 25, 26. — These are all nominal accounts showing the trading activities of the business. They are stated at the proper amounts and need no adjustment.

27. *Purchasing Expenses.* — This is a nominal account showing the cost of procuring goods and needs no adjustment.

28. *Freight and Hauling Inward.* — This is a nominal account showing cost of freight and hauling of goods purchased. It contains an item of $124 for freight on sales and must be decreased by that amount.

29. *Traveling Expenses.* — This is a nominal account requiring adjustment so as to include total expenses for the period. The adjustment for item #17 is charged to this account.

30. *Salaries and Wages.* — This is a nominal account that must be adjusted to include salaries earned to date but not paid. The amount accrued since last pay day is $260.

31. *Warehouse Expenses.* — This is a nominal account correctly stated and requires no adjustment.

32. *Advertising.* — This is a nominal account correctly stated and requires no adjustment.

33. *Delivery Expenses.* — This is a nominal account including shipping supplies on hand amounting to $280. An asset account must be set up decreasing the expense account by that amount.

34. *General Office Expenses.* — This is a nominal account including office supplies on hand amounting to $72. Supplies on hand must be transferred to an asset account decreasing General Office Expenses account by that amount.

35. *Real Estate Expense.* — This is a nominal account representing the cost of maintaining property used in the business and takes the place of rent. It must be adjusted to include the interest on mortgage, $780, referred to in #18.

A part of the office is sublet at $50 per month. On December 15, the tenant paid a month's rent in advance which was credited to this account. An adjustment must be made, therefore, for a half month's rent by bringing into the accounts the liability to the tenant for the unearned rent.

36. *Interest Expense.* — This is a nominal account requiring adjustment to include interest accrued on notes payable, $12.50, referred to in #20.

37. *Sales Discount.* — This is a nominal account showing the amount of cash discounts allowed customers. It is stated correctly and needs no adjustment.

38. *Interest Income.* — This is a nominal account requiring adjustment to include interest items referred to in #4.

39. *Purchases Discount.* — This is a nominal account showing cash discounts allowed by creditors. It is correctly stated and needs no adjustment.

40. *Income from Investments.* — This is a nominal account showing the amount of income received from bonds owned. In order to show the income for the entire period it must be adjusted to include interest accrued referred to in #15.

EXERCISE 15-a

George Ward

Trial Balance, December 31, 1926 (Before adjusting)

1.	Cash in Bank	$ 3,420.50	
2.	Petty Cash Fund	225.00	
3.	Accounts Receivable	108,420.10	
4.	Notes Receivable	12,560.00	
5.	Merchandise Inventory December 31, 1925	110,590.10	
6.	Land	30,000.00	
7.	Buildings (cost)	74,850.00	
8.	Reserve for Depreciation of Buildings		$ 15,970.00

Trial Balance (Cont.)

9.	Office Equipment (cost)	$ 6,800.00	
10.	Reserve for Depreciation of Office Equipment		$ 1,360.00
11.	Delivery Equipment (cost)	7,550.00	
12.	Reserve for Depreciation of Delivery Equipment		4,530.00
13.	Investments — Liberty Bonds	20,000.00	
14.	Accounts Payable		85,960.00
15.	Notes Payable		50,000.00
16.	Mortgage Payable		40,000.00
17.	George Ward, Capital		150,000.00
18.	Sales		739,329.70
19.	Sales Returns and Allowances	5,710.30	
20.	Purchases	680,284.20	
21.	Purchase Returns and Allowances		1,975.00
22.	Freight on Purchases	6,582.90	
23.	Purchasing Expenses	3,820.50	
24.	Salaries of Salesmen	8,400.00	
25.	Traveling Expenses	2,850.20	
26.	Advertising and Publicity	2,840.60	
27.	Delivery Expenses	4,248.10	
28.	Office Supplies	1,143.20	
29.	Telephone and Telegrams	195.00	
30.	General Office Expenses	675.30	
31.	Insurance Prepaid	450.00	
32.	Sales Discount	5,247.70	
33.	Purchases Discount		9,250.00
34.	Interest Income		331.60
35.	Interest Expense	1,842.60	
		$1,098,706.30	$1,098,706.30

Merchandise Inventory December 31, 1926 — $116,420

Required:

(*a*) Proceed as follows to analyze the above trial balance: Rule a sheet of paper with four columns. In the first column insert the account number shown in the trial balance; in the second column indicate whether the account is a real, nominal or mixed item; in the third column indicate whether it is asset, liability, capital, expense or income, or if a mixed account, which of these elements it may contain. In the fourth column, if a nominal or real item, indicate whether it is correctly stated or whether there may be additions to or deductions from it; if mixed, indicate what sort of adjustment is necessary.

(*b*) From the analysis in (*a*) prepare adjustment data under headings shown in illustration, page 121.

EXERCISE 15-b

The Emporium Company

Trial Balance, December 31, 1927

1.	Land	$ 10,000.00	
2.	Buildings — Brick	40,000.00	
3.	Fixtures and Equipment	8,000.00	
4.	Furniture and Office Equipment	7,500.00	
5.	Delivery Equipment — Automobiles	12,000.00	
6.	Investment — A. C. C. Co. — 6% Bonds	15,000.00	
7.	Cash	18,500.00	
8.	Accounts Receivable	2,200.00	
9.	Inventory January 1, 1927	80,000.00	
10.	Insurance Premiums	2,650.00	
11.	Taxes	2,400.00	
12.	Sales		$350,000.00
13.	Allowances to Customers	1,150.00	
14.	Purchases	245,000.00	
15.	Discounts Received		8,525.00
16.	Interest Charges	1,250.00	
17.	Capital		80,000.00
18.	Notes Payable		6,325.00
19.	Real Estate Mortgage		25,000.00
20.	Accounts Payable		16,500.00
21.	Taxes Accrued		800.00
22.	Selling Expenses	20,000.00	
23.	Delivery Expenses	6,500.00	
24.	Advertising	4,000.00	
25.	Office and General Expenses	11,000.00	
		$487,150.00	$487,150.00

Merchandise Inventory December 31, 1927 — $50,000

Required:

Analyze the foregoing trial balance and prepare a possible list of adjustment data to be considered in preparing adjustment entries. Proceed as instructed for Ex. 15-a.

QUESTIONS FOR DISCUSSION

1. Name the various steps in the bookkeeping procedure beginning with the business transaction and ending with the trial balance.

2. Beginning with the trial balance, outline the steps that follow until the post-closing trial balance is taken.

3. What is meant by a current trial balance?

4. What kinds or classes of accounts are usually found in a current trial balance?

5. Why is it necessary to analyze the current trial balance before making adjustment entries?

6. What is the purpose of compiling a list of adjustment data?

7. Outline the sources of the items found in the adjustment data on page 121.

8. Will an inspection of the trial balance reveal all the adjustment data?

9. Why are mixed accounts used since they must be eliminated at the close of the fiscal period?

10. Explain just what procedure is necessary to properly analyze the current trial balance.

11. At the end of the fiscal period the analysis of a firm's trial balance discloses the following schedule of adjustment data which should be considered preparatory to setting up the financial statements:

(1) Merchandise inventory, $12,000.

(2) It is estimated that 1% of the balance due from customers, $8,450, will not be collected.

(3) A. T. Richards, a customer, has failed in business and his account amounting to $350 is a total loss.

(4) Depreciation should be considered on the following items:

Buildings	costing	$40,000,	3%	per	annum
Office Equipment	"	1,250,	10%	"	"
Delivery Equipment	"	2,600,	25%	"	"

(5) Insurance unexpired amounts to $112.

(6) Supplies on hand:

In shipping department, $270.

In general office, $50.

(7) Interest items are as follows:

Accrued on notes receivable, $12.50.

Prepaid on notes payable at the bank, $15.

State what accounts would usually be affected by each of the above items and what adjustment entry would be necessary.

CHAPTER XVI

ADJUSTMENT ENTRIES

Preparation of Adjusting Journal Entries. — After the current trial balance has been analyzed, as explained in the previous chapter, and a list of adjustment data prepared, the next step is to set these adjustments up in journal entry form so that the accounts in the trial balance may be corrected and brought into agreement with existing facts as far as possible. If this is done at the end of the fiscal period, the ledger will be closed and, therefore, these entries are made in the General Journal and posted to the ledger the same as any other journal entries. They should, however, be recorded on separate pages with a proper heading. An adjusted trial balance is then taken from the ledger. When monthly financial statements are desired, and the ledger is not to be closed, a work sheet is used and the journal entries, instead of being posted to the ledger, are carried directly to the adjustment columns in the work sheet as shown in the illustration on pages 140 and 141. In either case the entries should be written up with care and placed on file for future reference. Special attention should be given to see that the explanations are full and complete.

Accounts to be Used. — In preparing the adjusting entries the classification of accounts in the trial balance should be followed as far as possible and no new accounts added when it is possible to adjust an item through an account already on the books. For instance, the depreciation items in entries 3, 4, 5, 6, on pages 132 and 133 in each case could be charged to a separate depreciation account but, by using the accounts in the trial balance, the depreciation on building is charged to Real Estate Expense account; the depreciation on office equipment to General Office Expenses account, etc. This avoids using so many expense accounts and saves considerable clerical work. If for some special reason it is desirable to show the various depreciation expenses separately in the financial statements, then the depreciation accounts are used.

In preparing adjustment entries, compound journal entries each having several debits and credits should be avoided as much as possible as they are difficult to explain properly. For instance, the four depreciation items could be set up in one journal entry if desired, but it is much better to show each separately so that proper explanations may be made.

The cost of expired insurance premiums in entry #7 could be distributed

to expense accounts already on the books if a basis for distribution were available — the insurance on the building being charged to Real Estate Expense; the insurance on office equipment to General Office Expenses, etc. Since the problem does not state the amount of insurance on each class of property, it is shown as one item, Insurance Expense, and will appear as such in the profit and loss statement.

In this solution the merchandise inventory is not included in the adjusting entries but is handled as a closing entry. This procedure is logical and gives complete information in the adjusted trial balance for preparation of the trading section of the profit and loss statement.

Interest on notes payable appears both as a deferred charge and as an accrued liability. This is due to the fact that a portion of the interest is paid in advance on a note discounted at the bank and is, therefore, a *deferred expense* item, while interest has accrued on other notes outstanding which is an *accrued expense*. In the same manner interest on notes receivable appears both as a deferred credit and as an accrued asset. Interest has been paid in advance by one customer and represents *deferred income* while interest on other notes on hand has accrued but is not due and is, therefore, *accrued income*.

Interest accrued on the mortgage is charged to Real Estate Expense account as it represents one of the expenses of owning real estate. The expense of carrying real estate takes the place of rent and should include all those items that would not be incurred if the building were rented from others instead of being owned. The income from subletting a portion of the office is credited to Real Estate Expense as it has the effect of reducing the cost of carrying property used for business purposes rather than increasing income.

The entries are numbered in the journal for reference purposes only, the same numbers appearing in the adjustment columns of the work sheet.

Adjustments When Reversing Entries Are Not Made. — When adjustment accounts are not reversed at the beginning of the next fiscal period as explained on page 74 but are allowed to remain on the books until the end of the succeeding period, instead of setting up the new adjustment figures it is necessary to correct the amounts already on the ledger, adjusting the difference through the proper expense or income accounts.

For example, assume that on December 31, 1926 an Office Expense account is debited with $520 and the inventory of office supplies on hand amounts to $85, while on December 31, 1927 the account is charged with $460 with supplies on hand amounting to $60. The adjustment entry at the end of the first period is as follows:

Office Supplies on Hand	$ 85.00	
Office Supplies		$ 85.00

The entry to close the expense account:

Profit and Loss	435.00	
Office Supplies		435.00

The entries for the following period are as follows:

Office Supplies	25.00	
Office Supplies on Hand		25.00
Profit and Loss	485.00	
Office Supplies		485.00

After posting these entries the ledger accounts appear as follows:

Office Supplies

1926						1926					
Dec.	31	Cost		520	00	Dec.	31	To Inventory		85	00
							31	To P. and L.		435	00
				520	00					520	00
1927						1927					
Dec.	31	Cost		460	00	Dec.	31	To P. and L.		485	00
	31	Inventory adj.		25	00						
				485	00					485	00

Office Supplies on Hand

1926						1927					
Dec.	31			85	00	Dec.	31	To Expense		25	00
		Bal. $60									

Under the reversing method explained on page 74, the ledger accounts appear as follows:

Office Supplies

1926						1926					
Dec.	31	Cost		520	00	Dec.	31	To Inventory		85	00
							31	To P. and L.		435	00
				520	00					520	00
1927						1927					
Jan.	1	Inventory		85	00	Dec.	31	To Inventory		60	00
Dec.	31	Cost		460	00		31	To P. and L.		485	00
				545	00					545	00

Office Supplies on Hand

1926 Dec.	31	Inventory		85	00	1927 Jan.	1	To reverse		85	00
1927 Dec.	31	Inventory		60	00						

Adjusting Journal Entries for E. M. Harvey. —

Adjusting Entries December 31, 1926

1	Reserve for Doubtful Accounts	110 00		
	Accounts Receivable--Customer			110 00
	To close uncollectible account into reserve account.			
	31			
2	Provision for Doubtful Accounts	267 00		
	Reserve for Doubtful Accounts			267 00
	To provide for future losses on account of bad debts by increasing the reserve to 2% of customers' balances:			
	2% of $14,150.20 $283.00			
	Balance of reserve 16.00			
	To adjust, as above $267.00			
	31			
3	Real Estate Expense	1500 00		
	Reserve for Depreciation of Building			1500 00
	To record estimated depr. on building for year ending Dec. 31, 1926 at 2% per annum based on cost: .02 x $75,000 = $1500.			
	31			
4	General Office Expenses	575 00		
	Reserve for Depreciation of Office Equipment			575 00
	To record estimated depr. on office equip. for year ending Dec. 31, 1926 at 10% per annum based on cost: .10 x $5,750 = $575.			
	31			
5	Warehouse Expenses	341 00		
	Reserve for Depr.of Warehouse Equip.			341 00
	To record estimated depr. on warehouse equip. for year ending Dec.31, 1926 at 10% per annum based on cost: .10 x $3,410 = $341.			

	31				
6	Delivery Expenses		480 00		
	Reserve for Depr. of Delivery Equip.				480 00
	To record estimated depr. on delivery equip. for year ending Dec. 31, 1926 at 20% per annum based on cost: .20 x $2,400 = $480.				
	31				
7	Insurance Expense		125 00		
	Insurance Prepaid				125 00
	To charge insurance premiums expired to expense account.				
	31				
8	Traveling Expenses		135 00		
	Advances to Salesmen				135 00
	To adjust accounts to show amount in hands of salesmen at end of year.				
	31				
9	Shipping Supplies on Hand		280 00		
	Delivery Expenses				280 00
	To record as an asset cost of supplies on hand, crediting expense account.				
	31				
10	Office Supplies on Hand		72 00		
	General Office Expenses				72 00
	To record as an asset cost of supplies on hand, crediting expense account.				
	31				
11	Interest Expense Prepaid		5 00		
	Interest Expense				5 00
	To record int. prepaid on 60-day note for $1,000 discounted Dec. 1.				
	31				
12	Interest Income		8 50		
	Interest Income Prepaid				8 50
	To record liability for interest received in advance on renewed note for $1,000.				
	31				
13	Real Estate Expense		25 00		
	Rent Receivable Prepaid				25 00
	To record liability for one-half month's rent paid in advance and credited to Real Estate Expense.				

	31				
14	Interest Income Accrued		9	20	
	Interest Income				9	20
	To record asset for interest accrued on notes receivable on hand.				
	31				
15	Income from Investments Accrued		75	00	
	Income from Investments				75	00
	To record asset for interest accrued on bond investment, $5000, for three months at 6%.				
	31				
16	Interest Expense		12	50	
	Interest Expense Accrued				12	50
	To record interest accrued on notes payable outstanding.				
	31				
17	Salaries and Wages		260	00	
	Salaries and Wages Accrued				260	00
	To record liability for wages for two days since last pay day.				
	31				
18	Real Estate Expense		780	00	
	Interest on Mortgage Accrued				780	00
	To record liability for interest on mortgage payable for six months.				
	31				
19	Delivery Expenses		124	00	
	Freight and Hauling Inward				124	00
	To transfer freight on sales to Delivery Expense--charged to Freight Inward in error.				

EXERCISE 16-a

An analysis of a trial balance containing the same classification of accounts as shown in the trial balance of E. M. Harvey on page 120 shows the following adjustment data at the close of the year:

(1) Depreciation of buildings

Cost of buildings, $60,000

Estimated life, 50 years

One-third of the space is used for general offices, and the remainder is used for storing and shipping goods.

(2) Delivery equipment which cost $5,000, is estimated to be worth $3,500. Trucks costing $2,500 are sold at the end of the year for $1,500.

The Reserve for Depreciation of Delivery Equipment in the trial balance shows a balance of $1,000.

An automobile costing $1,500, and for which no depreciation had been set up, was destroyed by fire. The amount received from the insurance company was credited to Delivery Equipment account, $1,000.

(3) Office equipment has depreciated 10%; cost $500.
Equipment costing $250 was sold for $150 and this amount credited to the equipment account.

(4) Inventory of office supplies on hand amounts to $72.50.

(5) Interest accrued to date on notes receivable, $24.10; on notes payable, $20.

(6) An account owed by Walter Haines amounting to $900, proves to be worthless. The Reserve for Doubtful Accounts account in the trial balance shows a balance of $1,291.60.

(7) The reserve for doubtful accounts is to be adjusted to equal 2% of the amount due from customers. The trial balance figures are as follows: Accounts Receivable, $23,582.90; Reserve for Doubtful Accounts as shown in (6).

(8) Salaries and wages earned but not paid amount to $240.

(9) Insurance premiums expired and chargeable to this period, $43.20.

(10) Shipping supplies on hand, $164.

Required:

Adjustment journal entries. Give special attention to the explanations.

EXERCISE 16-b

H. C. Cramer employs you to assist in closing his books. The current trial balance and additional facts to be considered are given below:

Trial Balance, December 31, 1926

Land	$ 25,000.00	
Buildings	30,000.00	
Office Equipment	5,000.00	
Delivery Equipment	4,500.00	
Merchandise Inventory, December 31, 1925	15,000.00	
Cash in Bank	9,000.00	
Petty Cash	200.00	
Accounts Receivable	3,850.00	
Notes Receivable	9,450.00	
Notes Receivable Discounted		$ 5,200.00
Accounts Payable		3,290.00
Notes Payable		4,500.00
H. C. Cramer, Capital		75,000.00
Purchases	92,270.00	
Sales		126,030.00

Trial Balance (Cont.)

Sales Returns and Allowances	$ 580.00	
Delivery Expenses	5,280.00	
Selling Expenses	7,580.00	
General Administrative Expenses	5,655.00	
Interest Expense	60.00	
Interest Income		$ 270.00
Purchases Discount		960.00
Loss on Bad Accounts	1,825.00	
	$215,250.00	$215,250.00

(1) Merchandise on hand December 31, 1926 — $18,000.

(2) Of the notes receivable discounted, two matured and were paid as follows: $1,200 on December 15, 1926 and $1,450 on December 25, 1926.

(3) Interest accrued on notes receivable, $24. Of the notes payable $1,500 is represented by a sixty-day note discounted at the bank on December 16 at 6%.

(4) A purchase of $250, made and goods received December 25, 1925, was entered on the books January 10, 1926.

(5) Three days' salary is due. Weekly payroll in each department: Delivery, $70; Selling, $150; Office, $80.

(6) Depreciation to be written off:

Buildings, estimated life 30 years.
Delivery equipment, estimated life 5 years.
Office equipment, estimated life 10 years.

(7) Estimated loss from doubtful accounts is 1% of the net sales for the period.

(8) Insurance premium unexpired on auto trucks, $50; on stock of goods, $75; on buildings and equipment, $85.

(9) Supplies on hand as follows: General office, $60; delivery, $120.

(10) Total delivery expense is to be distributed one-third to Purchases, and two-thirds to Selling Expenses.

Required:

(*a*) Adjustment journal entries with full particulars.

(*b*) Open ledger accounts and insert balances as shown by the foregoing trial balance. Post the adjustment entries to the ledger, opening such new accounts as may be necessary, and take off an adjusted trial balance.

EXERCISE 16-c

C. J. Burns

Trial Balance, June 30, 19—

Cash in Bank	$ 6,505.20
Notes Receivable	2,500.00

Accounts Receivable	$5,610.00	
Reserve for Doubtful Accounts		$ 25.10
Inventory, June 30, 19—	4,220.00	
Insurance Prepaid	240.00	
Office Supplies on Hand	55.10	
Delivery Equipment	3,200.00	
Reserve for Depreciation of Delivery Equipment		1,600.00
Office Equipment	570.00	
Reserve for Depreciation of Office Equipment		120.00
Land	3,000.00	
Buildings	6,000.00	
Reserve for Depreciation of Buildings		900.00
Accounts Payable		1,840.14
Notes Payable		2,500.00
Mortgage Payable		6,000.00
C. J. Burns, Capital		16,000.00
Purchases	14,501.95	
Purchase Returns		210.50
Sales		23,357.26
Sales Returns	120.25	
Selling Expenses	1,692.80	
Purchasing Expenses	981.53	
Real Estate Expenses	810.15	
General Administrative Expenses	1,972.20	
Sales Discount	415.62	
Purchases Discount		291.10
Interest Income		32.50
Interest on Mortgage Payable	150.00	
Shipping and Delivery Expenses	531.80	
Taxes Accrued		125.00
Interest Accrued on Mortgage Payable		75.00
	$53,076.60	$53,076.60

Merchandise Inventory June 30, 19—, $7,275.25

The following items are to be considered in preparing statements:

(1) Depreciation figured annually as follows:

(*a*) On office equipment 10%

(*b*) On buildings 3%

(*c*) On delivery equipment 25%

(2) Uncollectible accounts estimated at $130. Adjust the reserve accordingly.

(3) Interest accrued on notes receivable, $16.20.

(4) The real estate mortgage bears 5% interest, payable April 1 and Oct. 1.

(5) Interest on notes payable at 6% from May 1, 19—.

(6) Salaries earned and unpaid:

Salesmen	$92.00
Receiving clerks	42.00
General office	65.00
Shipping clerks	48.00

(7) It is ascertained from the bank statement that the bank has credited the checking account with $10.20 interest for the month of June.

(8) Taxes for the year are estimated to amount to $460.

(9) The insurance premiums unexpired amount to $80.

(10) Stationery and supplies on hand are valued at $32.

(11) Fuel on hand valued at $160 was charged to General Administrative Expenses when purchased.

(12) Telephone bill for May, $12.30, is not recorded.

Required:

Adjustment journal entries with full particulars. Note that certain adjustment accounts were not reversed at the close of the previous period. These items will be adjusted as explained on page 130.

QUESTIONS FOR DISCUSSION

1. What is the purpose of preparing adjusting journal entries?

2. When monthly financial statements are made, how do the adjusting entries differ from those when statements are prepared only at the *end of the fiscal period?*

3. Why is it important that the explanations to adjusting entries be clear and complete?

4. What determines the classification of accounts to be used in making the adjusting entries?

5. Why is it good practice to avoid compound journal entries in making adjustments?

6. Why was an Insurance Expense account used in adjusting entry #7 on page 133 instead of the expense accounts shown in the trial balance?

7. Should Merchandise Inventory be handled as an adjusting entry or a closing entry? Explain.

8. Interest on mortgage accrued in entry #18 is charged to Real Estate Expense. Under what circumstances would it be charged to another account? Name the account.

9. Rentals received are usually income. Why is rent received for subletting office space credited to Real Estate Expense in this exercise?

10. When adjustment accounts not used for current purposes are not reversed and closed at the beginning of the succeeding fiscal period but are allowed to remain open on the books, how are they adjusted at the end of the fiscal period?

CHAPTER XVII

THE WORK SHEET

Form and Purpose of the Work Sheet. — As stated in the previous chapter a work sheet is a ruled form or analysis sheet usually containing from six to twelve columns. For the purpose of analyzing the trial balance and proving the arithmetical results of financial statements it may consist of eight columns as illustrated on page 111. When used in place of the ledger, where the accounts are to be adjusted without closing the ledger, a twelve-column form is used as shown on pages 140 and 141. This chapter discusses and illustrates the use of the twelve-column work sheet.

Steps in Preparation of Work Sheet. — *First.* Copy the current trial balance on the work sheet by writing the names of the ledger accounts to the left and the debit and credit amounts in the first pair of columns, headed " Trial Balance as per Books." The trial balance is then footed and ruled and checked to see that the additions are correct and that no omissions have been made. The trial balance may be taken from the ledger directly to the work sheet if desired, making it unnecessary to recopy the same.

After the trial balance, which forms the basis of the work sheet, has been copied and verified, the adjustment journal entries are posted to the next pair of columns headed " Adjustments," care being taken to see that the amounts are entered on the same line as the title of the account in the debit or credit column, as the case may be. The number of each adjustment entry should appear at the left of the amount as shown in the illustration. This is for reference purposes in case of error.

Second. Prepare an adjusted trial balance in the columns headed " Adjusted Trial Balance " by combining the amounts in the first two sets of columns. This is accomplished by adding debit adjustments to debit balances in the current trial balance and subtracting any credit adjustment, the new balance being entered in the debit column of the third pair of columns. If the current trial balance shows a credit, credit adjustments are added and debit adjustments deducted, the balance being entered in the credit column of the third set of columns. By referring to the work sheet on page 140 it is readily seen how this is done. For instance, in the third item $267 is added to $126 and $110 deducted; the balance $283 is carried to the credit adjustment column.

E. M.

Work Sheet for Year

Accounts	Trial Balance per Books		Adjustments			
	Debits	Credits	Debits		Credits	
Cash	10250 90					
Accounts Receivable	14260 20				#1	110 00
Reserve for Doubtful Accounts		126 00	#1	110 00	#2	267 00
Notes Receivable	2550 00					
Inventory 12/31/25	15825 02					
Land	25000 00					
Building	75000 00					
Reserve for Depr. of Building		12000 00			#3	1500 00
Office Equipment	5750 00					
Reserve for Depr. of Office Equipment		750 00			#4	575 00
Warehouse Equipment	3410 00					
Res. for Depr. of Warehouse Equipment		645 40			#5	341 00
Delivery Equipment	2400 00					
Res. for Depr. of Delivery Equipment		600 00			#6	480 00
Investments	5000 00					
Insurance Prepaid	350 00				#7	125 00
Advances to Salesmen	210 00				#8	135 00
Mortgage Payable		26000 00				
Accounts Payable		12290 45				
Notes Payable		4000 00				
E. M. Harvey, Capital		75000 00				
E. M. Harvey, Current	5473 50					
Sales		180215 80				
Sales Returns and Allowances	3840 30					
Purchases	98885 00					
Purchase Returns and Allowances		2260 20				
Purchasing Expenses	530 60					
Freight and Hauling Inward	2460 00				#19	124 00
Traveling Expenses	5510 60		#8	135 00		
Salaries and Wages	18920 50		#17	260 00		
Warehouse Expenses	2410 00		#5	341 00		
Advertising	6823 00					
Delivery Expenses	3835 10		#19	124 00		
			#6	480 00	#9	280 00
General Office Expenses	2627 40		#4	575 00	#10	72 00
			#3	1500 00		
Real Estate Expense	2680 00		#13	25 00		
			#18	780 00		
Interest Expense	380 00		#16	12 50	#11	5 00
Sales Discount	530 88					
Interest Income		123 10	#12	8 50	#14	9 20
Purchases Discount		752 05				
Income from Investments		150 00			#15	75 00
	314913 00	314913 00				
Provision for Doubtful Accounts			#2	267 00		
Insurance Expense			#7	125 00		
Shipping Supplies on Hand			#9	280 00		
Office Supplies on Hand			#10	72 00		
Interest Expense Prepaid			#11	5 00		
Interest Income Prepaid					#12	8 50
Rent Receivable Prepaid					#13	25 00
Interest Income Accrued			#14	9 20		
Income from Investments Accrued			#15	75 00		
Interest Expense Accrued					#16	12 50
Salaries and Wages Accrued					#17	260 00
Interest on Mortgage Accrued					#18	780 00
				5184 20		5184 20
Gross Trading Profit						
Net Profit						

Inventory December 31, 19—, $18,234.20

Illustration — Twelve-Column Work Sheet (Left)

HARVEY

Ending December 31, 1926

Adjusted Trial Balance		Trading		Profit and Loss		Balance Sheet	
Debits	Credits	Debits	Credits	Expenses	Income	Assets	Liabilities and Capital
10250 90						10250 90	
14150 20						14150 20	
	283 00						283 00
2550 00						2550 00	
15825 02		15825 02	18234 20			18234 20	
25000 00						25000 00	
75000 00						75000 00	
	13500 00						13500 00
5750 00						5750 00	
	1325 00						1325 00
3410 00						3410 00	
	986 40						986 40
2400 00						2400 00	
	1080 00						1080 00
5000 00						5000 00	
225 00						225 00	
75 00						75 00	
	26000 00						26000 00
	12290 45						12290 45
	4000 00						4000 00
	75000 00						75000 00
5473 50						5473 50	
	180215 80		180215 80				
3840 30		3840 30					
98885 00		98885 00					
	2260 20		2260 20				
530 60		530 60					
2336 00		2336 00					
5645 60		121416 92	200710 20	5645 60			
19180 50				19180 50			
2751 00				2751 00			
6823 00				6823 00			
4159 10				4159 10			
3130 40				3130 40			
4985 00				4985 00			
387 50				387 50			
530 88				530 88			
	123 80				123 80		
	752 05				752 05		
	225 00				225 00		
267 00				267 00			
125 00				125 00			
280 00						280 00	
72 00						72 00	
5 00						5 00	
	8 50						8 50
	25 00						25 00
9 20						9 20	
75 00						75 00	
	12 50						12 50
	260 00						260 00
	780 00						780 00
319127 70	319127 70						
		79293 28			79293 28		
		200710 20	200710 20	47984 98	80394 13		
				32409 15			32409 15
				80394 13	80394 13	167960 00	167960 00

Illustration — Twelve-Column Work Sheet (Right)

Third. Analyze the adjusted trial balance and extend the amounts to the proper columns. Each item in the adjusted trial balance must be extended to one of the six columns at the right of the trial balance. The debit items in the adjusted trial balance are either trading debits, expenses, or assets; the credit items are either trading credits, income, or liabilities and capital items. The best procedure is to extend the items in the adjusted trial balance in their order to the proper columns rather than to extend trading, profit and loss, and balance sheet items separately. After the extensions have been made the various columns are footed in small pencil figures. The balance of the Trading columns shows the gross profit on sales for the year. The gross profit is then extended to the Income column, after which the balance of the Profit and Loss columns shows the net profit for the year. The net profit is then extended to the Liabilities column and brings the Assets and Liabilities columns into balance.

Use of Adjustment Columns. — The Adjustment columns provide for any corrections of or additions to the accounts in the ledger as shown by the current trial balance. The adjustment entries as shown on pages 132–134 are posted opposite the accounts in the trial balance; or if an account does not appear in the trial balance, it is inserted below the trial balance. For instance, entry #1 is posted to the debit adjustment column opposite the Reserve for Doubtful Accounts while the credit is posted to the credit adjustment column opposite Accounts Receivable. In entry #2, however, there is no account in the trial balance to receive the debit, and the title " Provision for Doubtful Accounts " has to be added below the trial balance and the amount entered in the debit adjustment column. The credit for this entry is entered in the credit adjustment column opposite Reserve for Doubtful Accounts.

When all the items have been posted, the adjustment columns are footed to see that there has been no error in posting. The columns are then ruled and the footings inserted. The combined values of the current trial balance and the adjustments are then extended to the Adjusted Trial Balance columns as explained above, and this second trial balance also footed. The adjusted trial balance is then extended to the following three pairs of columns.

The Trading Columns. — The use of the Trading columns is optional; but such columns have the advantage of bringing together the trading items that are shown in the trading section of the profit and loss statement. The balance of the Trading columns in the work sheet agrees with the gross trading profit as shown by the profit and loss statement and thus provides an additional check on those figures.

The *old inventory*, $15,825.02, is extended to the debit Trading column; while the *new inventory*, $18,234.20, which does not appear in the adjusted trial balance, is entered in both the credit Trading column and the Asset column, thus keeping the accounts in balance.

All items in the adjusted trial balance that have to do with sales and purchases are extended to the Trading columns for later preparation of the trading section of the profit and loss statement. Freight and Hauling Inward and Purchasing Expenses are a part of the cost of goods, and are extended to the debit Trading column and shown in the trading section of the profit and loss statement.

Trading, Profit and Loss, and Balance Sheet Columns. — These columns now provide information in convenient form for the preparation of the financial statements. All columns in the work sheet should now balance, the net profit as shown by the Profit and Loss columns being equal to the difference between the Balance Sheet columns. Care must be taken in making extensions. For instance, if an income item is extended as a liability or an expense item extended as an asset, the work sheet will balance but the result will be an incorrect profit or loss.

EXERCISE 17-a

H. C. Patton

Trial Balance, October 31, 19—

Cash	$ 5,898.54	
Accounts Receivable	4,524.38	
Merchandise Inventory, October 1, 19—	5,841.20	
Prepaid Insurance	72.00	
Furniture and Fixtures	1,225.00	
Real Estate	6,000.00	
Accounts Payable		$ 7,300.33
Mortgage Payable		4,000.00
H. C. Patton, Capital		6,000.00
Purchases	19,282.11	
Sales		29,669.40
Freight Inward	211.00	
Purchasing Expenses	780.50	
Selling Expenses	1,290.00	
General Administrative Expenses	1,845.00	
	$46,969.73	$46,969.73

Merchandise on hand is valued at $7,052.91

Required:

Work sheet, six columns. Use form shown on page 111, omitting the Trading columns. Show the trading items in the Expense and Income columns.

EXERCISE 17-b

Henry Walton requests you to make out statements which will show his financial condition at December 31 and the results of operating for the year.

The trial balance at December 31, 1926 is as follows:

Cash	$ 465.50	
Accounts Receivable	2,672.50	
Notes Receivable	300.00	
Merchandise Inventory, January 1, 1926	1,850.25	
Furniture and Fixtures	250.00	
Automobiles	1,800.00	
Accounts Payable		$ 1,450.00
Notes Payable		500.00
Henry Walton, Capital		4,000.00
Salary of Salesmen	1,200.00	
Office Salaries	1,500.00	
Rent	1,200.00	
Telephone and Telegraph	84.00	
Office Supplies, Stationery	120.00	
Sundry Expenses	350.00	
Auto Expense	1,000.00	
Purchases	28,675.00	
Interest Expense	25.00	
Sales Discount	74.50	
Interest Income		15.00
Purchases Discount		115.00
Sales		35,486.75
	$41,566.75	$41,566.75

The inventories at December 31, 1926 are as follows:

Merchandise	$1,650.00	Office supplies	$45.00
Auto supplies	75.00		

There are accruals as follows:

Interest on notes receivable	$ 4.62	Office salaries	25.00
Interest on notes payable	11.17		

Required:

(*a*) Adjustment journal entries on a sheet of journal paper.

(*b*) Work sheet, eight columns. Transfer adjustment entries from journal to the Adjustment columns in the work sheet and extend adjusted figures to Profit and Loss

and Balance Sheet columns. Do not show adjusted trial balance on the work sheet.

EXERCISE 17-c

From the following data set up a profit and loss statement and balance sheet as of December 31, 19—:

Accounts Receivable	$ 34,000.00
Accounts Payable	15,000.00
Cash	4,500.00
Notes Receivable	2,500.00
Land	6,400.00
Building	12,000.00
Notes Payable	10,000.00
J. W. Gale, Capital	26,500.00
J. W. Gale, Drawings	5,400.00
Purchases	174,000.00
Returns	6,500.00
Freight In	1,700.00
Sales	253,400.00
Sales Returns	4,600.00
Inventory January 1, 19—	6,300.00
Auto Truck	3,800.00
General Administrative Expenses	19,000.00
Selling Expenses	22,000.00
Delivery Expenses	10,000.00
Sales Discounts	3,800.00
Purchases Discounts	4,000.00
Interest Expense	248.00
Interest Income	150.00
Provision for Bad Accounts	1,190.00
Insurance Unexpired	112.00
Equipment	4,000.00

Inventories, December 31, 19—:		
Merchandise	$7,500.00	
Office supplies	150.00	
Auto supplies	100.00	
Accruals, December 31, 19—:		
Taxes		$ 400.00
Interest on notes payable		100.00
Salaries and wages (general, $140; selling, $80; delivery, $40)		260.00
Interest on notes receivable		15.00

Depreciation:

Building, 2½%; auto truck, 25%; equipment, 10%

Anticipated loss on accounts receivable, 1½%

Insurance premiums expired, $22.00.

Required:

(*a*) Adjustment journal entries.

(*b*) Work sheet, twelve columns. Use form shown on pages 140 and 141.

EXERCISE 17-d

The following information is taken from a set of books on December 31, 1926:

Cash on Hand	$ 50.32
Cash in Bank	3,382.57
Notes Receivable	3,082.45
Furniture and Fixtures	405.66
Drawings	2,000.00
Expenses: New York Office	1,881.09
General Office	1,497.31
Notes Payable	650.95
Cash Discount Received	4,412.10
Cash Discount Allowed	2,620.26
Purchases	127,821.21
Sales	133,361.70
Accounts Receivable	10,451.94
Accounts Payable	4,131.56
Reserve for Doubtful Accounts	1,725.98
Capital Account, January 1, 1926	8,910.52

At the time of closing the books for the year, the following will be considered:

(1) Interest on bank balance not entered in the books, $8.25.

(2) Statement from the bank gives the amount of collection charges, $4.29.

(3) A note for $250 which is worthless has been retained on the books.

(4) Accrued interest on Notes Payable, $11.50.

(5) An analysis of the Cash Discount Received reveals the fact that $950.50 is trade discount and the remainder cash discount.

(6) $820.20 of the Cash Discount Allowed is trade discount.

(7) Of the amount due from debtors $850 was owing by a bankrupt who has been released from debt by the court.

(8) Expense bills accrued belonging to the New York office amount to $45.

(9) The amount reported as Expenses, New York office, $1,881.09, includes freight on purchases amounting to $175.

(10) Make provision for a reserve for depreciation of furniture and fixtures of 10% of book value.

(11) Add to Reserve for Doubtful Accounts 2% on amounts due from debtors.

Required:

(*a*) Adjustment journal entries.

(*b*) Work sheet, ten columns, showing adjusted trial balance but omitting Trading columns.

EXERCISE 17-e

Copy the trial balance of C. J. Burns in Exercise 16-c on a twelve-column work sheet. Post the adjusting entries prepared for this exercise to the Adjustment columns and complete the work sheet by making an adjusted trial balance and extending the same to the proper columns. Use form illustrated on pages 140 and 141.

QUESTIONS FOR DISCUSSION

1. Is the work sheet considered as a part of the financial statement?
2. Where is the data used in the preparation of the work sheet obtained?
3. What purpose does the work sheet serve in the preparation of the financial statements?
4. How are the amounts in the adjusted columns combined with those in the trial balance?
5. Is it necessary to show the adjusted trial balance on the work sheet? Explain the procedure when this is omitted.
6. When the adjusted trial balance is shown on the work sheet, what further use is made of the current trial balance and adjustments?
7. Why is the ability to classify the items in the adjusted trial balance as assets, liabilities, capital, trading, expense and income necessary in preparing the work sheet?
8. Why is the new inventory inserted both in the credit Trading column and in the Asset column?
9. What is the purpose of the Trading columns in the work sheet?
10. When Trading columns are not used, how is the data handled that is usually entered in those columns?
11. Explain how it is possible for a work sheet to balance and yet be incorrect.
12. What does the difference between the Trading columns represent and how is it entered?
13. What does the difference between the Expense and Income columns represent and how is it entered?
14. Is it necessary to use a work sheet in preparing the statements? Under what circumstances is it most useful?
15. What determines the number of columns to be used in the work sheet?
16. Name the detailed headings for the columns when six columns are used; eight columns; ten columns; twelve columns.
17. When completed, what is done with the work sheet?

CHAPTER XVIII

THE FINANCIAL STATEMENTS

Preparation of the Balance Sheet. — The items for the balance sheet are taken from the Balance Sheet columns of the work sheet. After the heading has been set up on two lines and properly underlined and dated as shown on page 149, the grouping is decided upon. The two principal sections or groups are headed " Assets " and " Liabilities and Capital." The sub-headings of the asset group for this problem are " Current Assets," " Investments," " Fixed Assets," and " Deferred Charges to Profit and Loss." If desired, the " Fixed Assets " group may appear first followed by the others in the order named. For most purposes current assets should appear first, especially for the proprietor's personal use and for the use of those requiring statements as a basis for the extension of credit or for loaning money.

The " Liabilities and Capital " section has the following subheadings: " Current Liabilities," " Deferred Income," " Fixed Liabilities " and " Capital." Capital is always shown last but current and fixed liabilities should appear in the same order as the current and fixed assets.

The word " cost " after fixed asset items indicates that depreciation has not been deducted but appears in the reserve accounts, which are, therefore, deducted from the cost of the asset to determine the book value.

Investments in bonds are shown under a separate heading between the current and fixed assets as this item may be either fixed or current. If purchased with the intention of holding them until they mature they are considered fixed assets; if they are to be held only temporarily to use surplus funds they may be considered current assets.

The underlining, punctuation, and various indentations are for the purpose of making the statement more readable and should receive careful attention. The dollar sign is used at the top of each column of figures and is repeated whenever the column is broken by a horizontal ruling. When books and forms with vertically ruled columns are used the dollar sign is omitted.

In preparing the balance sheet, if the items are numerous it may be advisable to label the various assets in the work sheet in the same manner as explained on page 109 for analysis of the trial balance, and number them in the order in which they should appear in each group; as 1 ca, 2 ca, etc.

E. M. Harvey

Balance Sheet, December 31, 1926

Assets

Current Assets:			
Cash		$10,250.90	
Accounts Receivable	$14,150.20		
Less-Res. for Doubtful Accounts	283.00	13,867.20	
Notes Receivable		2,550.00	
Merchandise Inventory		18,234.20	
Accrued Items:			
Interest on Notes Receivable	$ 9.20		
Income from Investments	75.00	84.20	$ 44,986.50
Investments (Bonds)			5,000.00
Fixed Assets:			
Land (Cost)		$25,000.00	
Building (Cost)	$75,000.00		
Less-Reserve for Depreciation	13,500.00	61,500.00	
Office Equipment (cost)	$ 5,750.00		
Less-Reserve for Depreciation	1,325.00	4,425.00	
Warehouse Equipment (cost)	$ 3,410.00		
Less-Reserve for Depreciation	986.40	2,423.60	
Delivery Equipment (cost)	$ 2,400.00		
Less-Reserve for Depreciation	1,080.00	1,320.00	94,668.60
Deferred Charges to Profit and Loss:			
Insurance Prepaid		$ 225.00	
Advances to Salesmen		75.00	
Shipping Supplies on Hand		280.00	
Office Supplies on Hand		72.00	
Interest Expense Prepaid		5.00	657.00
Total Assets			$145,312.10

Liabilities and Capital

Current Liabilities:			
Accounts Payable		$12,290.45	
Notes Payable		4,000.00	
Accrued Items:			
Interest Expense	$ 12.50		
Salaries and Wages	260.00		
Interest on Mortgage	780.00	1.052.50	$ 17,342.95
Deferred Income:			
Interest on Notes Receivable		$ 8.50	
Rent Receivable		25.00	33.50
Fixed Liabilities:			
Mortgage Payable			26,000.00
Total Liabilities			$ 43,376.45
Capital:			
Investment		$ 75,000.00	
Add-Profit for Year ending December 31, 1926	$32,409.15		
Less-Drawings for 1926	5,473.50	26,935.65	101,935.65
Total Liabilities and Capital			$145,312.10

Preparation of the Profit and Loss Statement. — The profit and loss statement is prepared for the purpose of analyzing the net profit of $32,409.15 and showing from what source it was derived. This is done by listing the various expense and income items for the period. The information for this statement is taken from the Trading and Profit and Loss columns of the work sheet. When the work sheet is not used it is taken from the adjusted trial balance.

The items of this statement are divided into four groups or sections; the Trading section; the "Operating Expenses" section; the "Other Income" section; and the "Other Expenses" section. They will appear in the order named unless the business shows a net trading loss, in which case the order of the last two sections is reversed, Other Expenses being added to the trading loss and Other Income deducted from the sum.

After the heading is set up on two lines showing not only the date but indicating the entire period covered, the Trading section is prepared from the items as shown in the Trading columns of the work sheet. This section includes all those items that have to do directly with the cost and sale of merchandise. Freight and Hauling Inward are considered as a part of the cost of goods and are included in this section. Purchases and sales discounts, when large enough to amount to trade discounts (usually above 5%), may be deducted from the Purchases and Sales accounts respectively. Trade discounts are not usually recorded on the books and do not appear in the profit and loss statement, but when recorded they are deducted the same as returns and allowances. Normal cash discounts are handled in the same manner as interest received and interest paid and are, therefore, shown as Other Income and Other Expenses.

Methods of Classifying Operating Expenses. — The next section to receive attention is that for Operating Expenses. This section includes all ordinary expenses for the successful operation of the business. These expenses are such as are incurred by other concerns in the same line of business. There are three common methods of classifying these expenses in the profit and loss statement:

(1) Detailed accounts may be used, the extent of the detail being determined by the kind and size of the business and the wishes of the proprietor. The accounts may be listed in the order of their importance, the larger items being placed first.

(2) Detailed accounts may be used and grouped under the subheadings of Selling, General Administrative, etc.

(3) Only summary or group totals may be shown in the profit and loss statement. If details are desired they are shown in separate schedules.

A modification of the first plan is used in the statement illustrated on page 151,

E. M. Harvey

Profit and Loss Statement for Year Ending December 31, 1926

Gross Sales		$180,215.80	
Less-Returns and Allowances		3,840.30	
Net Sales			$176,375.50
Deduct-Cost of Goods Sold:			
Inventory December 31, 1925		$ 15,825.02	
Gross Purchases	$98,885.00		
Less-Returns and Allowances	2,260.20		
Net Purchases		96,624.80	
Freight and Hauling Inward		2,336.00	
Purchasing Expenses		530.60	
Total Cost of Goods		$115,316.42	
Less-Inventory December 31, 1926		18,234.20	
Cost of Goods Sold			97,082.22
Gross Trading Profit			$ 79,293.28
Deduct-Operating Expenses:			
Salaries and Wages		$ 19,180.50	
Traveling Expenses		5,645.60	
Advertising		6,823.00	
Delivery Expenses		4,159.10	
Warehouse Expenses		2,751.00	
Real Estate Expense		4,985.00	
General Office Expense		3,130.40	
Insurance Expense		125.00	
Total Operating Expenses			46,799.60
Net Trading Profit			$ 32,493.68
Add-Other Income:			
Purchases Discount		$ 752.05	
Interest Income		123.80	
Income from Investments		225.00	
Total Other Income			1,100.85
Total Income			$ 33,594.53
Deduct-Other Expenses:			
Sales Discount		$ 530.88	
Interest Expense		387.50	
Provision for Doubtful Accounts		267.00	
Total Other Expenses			1,185.38
Net Profit			$ 32,409.15

the details being reduced to eight items. In order to use the other methods it would be necessary to make some distribution of Salaries and Wages, and Insurance Expense. Real Estate Expense account as used in the statement includes expenses in connection with the property owned and used in the business and takes the place of rent. Delivery Expenses includes all costs of maintaining and operating delivery equipment with the exception of insurance and wages.

When set up under the second method the items are listed as follows:

Deduct — Operating Expenses:			
Selling Expenses:			
Salaries and Wages	xxx		
Traveling Expenses	xxx		
Advertising	xxx		
Delivery Expenses	xxx		
Warehouse Expenses	xxx	xxx	
General Administrative Expenses:			
Salaries and Wages	xxx		
Real Estate Expense	xxx		
General Office Expenses	xxx		
Insurance Expense	xxx	xxx	
Total Operating Expenses			xxx

The arrangement under the third method is as follows:

Deduct — Operating Expenses:		
Selling Expenses (See Schedule 1)	xxx	
General Administrative Exp. (See Schedule 2)	xxx	
Total Operating Expenses		xxx

The total of the operating expenses deducted from the *gross trading profit* shows the *net trading profit,* or the profit from regular operation of the business before taking into consideration financial expenses and those items not considered as necessary for all firms in the same line of business.

Other Income and Other Expenses Sections. — The Other Income section is next prepared and includes all income items not directly received from the sale of goods, such as interest and discounts. In this statement they are Purchases Discount, Interest Income, and Income from Investments. The total of this group added to the *net trading profit* shows *total income* for the year.

Other Expenses refer to financial expenses or those necessary in obtaining capital (expenses that firms with ample capital do not have to incur), together

with items beyond the control of the proprietor. In this statement they include Sales Discount, Interest Expense, and Provision for Doubtful Accounts. The total of this group deducted from *total income* shows *net profit* for the period.

Attention should be given to underlining, punctuation, and indentation so that the statement may have a finished appearance. Margins should be kept straight, indentations uniform and not too wide, and important items should be underlined — red ink may be used if available — so that the reader may find them more readily. Care should be taken in arranging the statement so that the condition of the business may be readily understood by the proprietor.

EXERCISE 18-a

The trial balance of Frank Gross at December 31, 1926, is as follows:

Cash	$ 2,228.24	
Accounts Receivable	15,615.48	
Notes Receivable	2,375.00	
Merchandise Inventory, December 31, 1925	5,245.89	
Stationery on Hand	78.50	
Office Equipment	670.50	
Auto Truck	1,440.00	
Sales		$30,549.81
Sales Returns and Allowances	349.78	
Purchases	18,289.76	
Purchase Returns and Allowances		219.80
Freight Inward	1,250.00	
Accounts Payable		4,279.00
Notes Payable		1,500.00
Interest on Notes Payable	22.50	
Interest on Notes Receivable		50.00
Frank Gross, Capital		20,075.41
Frank Gross, Drawings	2,500.00	
Selling Expenses	1,960.00	
Delivery Expenses	1,540.00	
Discount on Purchases		493.81
General Administrative Expenses	3,015.00	
Purchasing Expenses	210.00	
Discount on Sales	217.68	
Discount on Notes Receivable	7.25	
Sale of Waste		149.75
Loss on Bad Debts	302.00	
	$57,317.58	$57,317.58

Inventories:	
Merchandise, December 31, 1926	$4,892.00
Stationery	225.00
Auto supplies	123.00
Accruals:	
On notes owing by Mr. Gross	$15.00
On notes on hand	72.50
Depreciation:	
Office equipment	10%
Auto truck	20%

Required:

Balance Sheet — Statement Form.

EXERCISE 18-b

The following data is taken from the adjusted trial balance of W. B. Whitney:

Inventory March 31, 1925, $95,000; inventory March 31, 1926, $120,000; purchases, $230,000; purchase returns and allowances, $2,500; sales, $310,000; sales returns and allowances, $3,260; income from sale of waste, $225; interest on mortgage payable, $675; interest on notes payable, $510; interest on bank deposits, $95; provision for bad accounts, $1,850; freight inward, $2,480; real estate expense, $3,500; purchasing expenses, $5,825; general administrative expenses, $12,500; delivery expenses, $9,360; selling expenses, $48,560; purchase discounts, $5,345.

Required:

Prepare a profit and loss statement for the year ending March 31, 1926. (See model form.)

EXERCISE 18-c

The following accounts are taken from the books of J. L. Rice, Dec. 31, 1926.

Inventory January 1, 1926, $2,565; cash, $2,500; freight inward, $120; notes receivable discounted, $1,200; purchases, $9,050; salesmen's salaries, $850; advertising, $300; interest on notes receivable, $150; purchase returns, $643; discount on sales, $98; office salaries, $900; sales, $14,500; discount on purchases, $185; mortgage payable, $5,000; interest on mortgage payable, $300; sales returns, $160; freight outward, $120; interest on notes payable, $50; accounts payable, $1,335; accounts receivable, $4,500; loss on bad debts, $300. The inventory of unsold merchandise is $5,400.

Required:

Prepare a profit and loss statement.

EXERCISE 18-d

Prepare balance sheet and profit and loss statement for J. W. Gale from work sheet called for in Exercise 17-c.

EXERCISE 18-e

Prepare balance sheet and profit and loss statement for C. J. Burns from work sheet called for in Exercise 17-e.

QUESTIONS FOR DISCUSSION

1. Which should be prepared first, the balance sheet or the profit and loss statement? Why?
2. What is the first thing to be decided upon before setting up the balance sheet?
3. What determines the order of the groups of assets and liabilities in the balance sheet?
4. Is it possible to secure all the information needed for the balance sheet from the balance sheet columns of the work sheet?
5. Outline a method of marking the items in the balance sheet columns so as to assist in listing the items in the balance sheet.
6. What is the purpose of a profit and loss statement?
7. From what columns is the data taken for the profit and loss statement? Is it possible to secure all the information from these columns?
8. Name the four sections of the profit and loss statement and indicate in what order they should appear. What circumstances will change the usual order of these items?
9. What types of expenses are included under "Operating Expenses" and what types under "Other Expenses"?
10. Name the usual ledger accounts that provide the information for the Trading section of the statement.
11. Outline the three methods of classifying operating expenses in the profit and loss statement.
12. Are all bookkeepers in agreement as to the items that should be shown in each section of the profit and loss statement? If not, name a few items about which there is disagreement.
13. What types of items are included under "Other Income"?
14. Why is it important that the financial statements be prepared with great care?

CHAPTER XIX

CLOSING JOURNAL ENTRIES

Preparation of Closing Journal Entries. — The items for the closing journal entries are taken from the profit and loss statement illustrated on page 151. The method illustrated is known as the Trading method. Under this method of closing the nominal accounts in the ledger all merchandising or trading items as shown in the Trading section of the profit and loss statement are transferred to a Trading account. The use of the Trading account was explained on page 102. The entries to close the various expense and income accounts are exactly the same as those under the Cost of Sales method with which the student is already familiar.

The closing entries are made in the order in which the items appear in the profit and loss statement. When these entries are posted to the ledger all nominal accounts will be closed and the Trading and Profit and Loss accounts will appear as shown on pages 158 and 159. Care should be taken in showing particulars of closing entries in the ledger. If the proprietor wishes to withdraw his profits from the business or if he desires that his investment account be not disturbed, the last entry closing the balance of Current account to Capital will be omitted. If a Current account is not kept in the ledger, the net profit or net loss will be closed directly into the Capital account.

Closing Journal Entries — E. M. Harvey. —

Closing Entries--December 31, 1926

Sales		3840	30		
	Sales Returns and Allowances			3840	30
	To transfer sales returns and allowances to Sales account.				
31					
Sales		176375	50		
	Trading			176375	50
	To transfer net sales to Trading account.				
31					
Trading		15825	02		
	Merchandise Inventory			15825	02
	To transfer to Trading account cost of goods on hand 12/31/25.				

31				
Purchase Returns and Allowances		2260	20	
Purchases				2260	20
To transfer purchase returns and allowances to Pur. account.				
31				
Trading		96624	80	
Purchases				96624	80
To transfer net purchases to Trading account.				
31				
Trading		2336	00	
Freight and Hauling Inward				2336	00
To transfer to Trading account cost of freight and hauling on goods bought during year.				
31				
Trading		530	60	
Purchasing Expenses				530	60
To transfer to Trading account cost of procuring goods during year.				
31				
Merchandise Inventory		18234	20	
Trading				18234	20
To transfer to Inventory account cost of goods on hand 12/31/26.				
31				
Trading		79293	28	
Profit and Loss				79293	28
To transfer to Profit and Loss account the gross trading profit for the year as shown by the balance of Trading account.				
31				
Profit and Loss		46799	60	
Salaries and Wages				19180	50
Traveling Expenses				5645	60
Advertising				6823	00
Delivery Expenses				4159	10
Warehouse Expenses				2751	00
Real Estate Expense				4985	00
General Office Expenses				3130	40
Insurance Expense				125	00
To transfer to Profit and Loss account the balance of all operating expense accounts for the year.					

	31				
	Purchases Discount	752	05		
	Interest Income	123	80		
	Income from Investments	225	00		
	Profit and Loss			1100	85
	To transfer to Profit and Loss account the balances of income accounts other than trading.				
	31				
	Profit and Loss	1185	38		
	Sales Discount			530	88
	Interest Expense			387	50
	Provision for Doubtful Accounts			267	00
	To transfer to Profit and Loss account the balances of expense accounts other than operating.				
	31				
	Profit and Loss	32409	15		
	E. M. Harvey, Current			32409	15
	To transfer to Mr. Harvey's current account the net profit for the year as shown by the balance of the Profit and Loss account.				
	31				
	E. M. Harvey, Current	26935	65		
	E. M. Harvey, Capital			26935	65
	To transfer to Capital account the balance of Mr. Harvey's current account 12/31/26.				

Trading and Profit and Loss Accounts Closed — E. M. Harvey. —

Trading

1926					1926				
Dec.	31	Inventory 12/31/25	15825	02	Dec.	31	Net Sales	176375	50
	31	Net Pur.	96624	80		31	Inventory 12/31/26	18234	20
	31	Freight In.	2336	00					
	31	Pur. Exp.	530	60					
	31	Gr. Profit	79293	28					
			194609	70				194609	70

Profit and Loss

1926						1926					
Dec.	31	Op. Exp.	46799	60		Dec.	31	Gr. Profit	79293	28	
	31	Other Exp.	1185	38			31	Other Income	1100	85	
	31	E. M. H., Cur.	32409	15							
			80394	13					80394	13	

Preparation of Reversing Journal Entries. — The purpose of the reversing entries is to close out all those temporary or adjustment accounts set up at the close of the fiscal period in order to adjust other accounts. Only current accounts to which items are posted during the period then remain open in the ledger. This is done by transferring the balances of such accounts back to the expense or income accounts from which taken when the adjusting entries were made. This results in each period being charged with the expense and credited with the income applicable thereto.

For instance, after posting adjusting entries in the model exercise affecting Delivery Expenses account the balance of that account is closed into Profit and Loss account. This leaves the adjustment account, Shipping Supplies on Hand, to which the unused supplies were transferred, open in the ledger. To close this account the reversing entry is made under date of January 1. The ledger accounts then appear as follows:

Delivery Expenses

1926					1926				
Dec.	31	Balance	3835	10	Dec.	31	Sup. on hand	280	00
	31	Depreciation	480	00		31	To P. and L.	4159	10
	31	Freight out	124	00					
			4439	10				4439	10
1927									
Jan.	1	Balance	280	00					

Shipping Supplies on Hand

1926					1927				
Dec.	31		280	00	Jan.	1	To reverse	280	00

The effect of the reversing entry is to charge the value of supplies on hand at the close of the 1926 fiscal period as an expense for the 1927 fiscal period when it will be consumed. The same principle applies to the other accounts reversed in the solution to the illustrative problem.

Reversing Journal Entries — E. M. Harvey. —

Reversing Entries--January 1, 1927

Delivery Expenses		280	00	
Shipping Supplies on Hand				280	00
To charge shipping supplies on hand as expense for ensuing period.					
1					
General Office Expenses		72	00	
Office Supplies on Hand				72	00
To charge office supplies on hand as expense for ensuing period.					
1					
Interest Expense		5	00	
Interest Expense Prepaid				5	00
To charge prepaid interest as expense for ensuing period.					
1					
Interest Income Prepaid		8	50	
Interest Income				8	50
To credit prepaid income as income for ensuing period.					
1					
Rent Receivable Prepaid		25	00	
Real Estate Expense				25	00
To credit prepaid rent to Real Estate Expense for ensuing period.					
1					
Interest Income		9	20	
Interest Income Accrued				9	20
To charge interest income accrued to current account.					
1					
Income from Investments		75	00	
Income from Investments Accrued				75	00
To charge investment income accrued to current account.					
1					
Interest Expense Accrued		12	50	
Interest Expense				12	50
To credit interest expense accrued to current account.					
1					
Salaries and Wages Accrued		260	00	
Salaries and Wages				260	00
To credit salaries and wages accrued to current account.					
1					
Interest on Mortgage Accrued		780	00	
Real Estate Expense				780	00
To credit interest accrued on mortgage to current account.					

Preparation of Post-Closing Trial Balance. — The post-closing trial balance is prepared from the ledger after the closing and reversing entries have been posted and is for the purpose of proving that the ledger is in balance before beginning the work of the next fiscal period. The items in this trial balance are practically the same as those in the balance sheet.

E. M. Harvey
Post-Closing Trial Balance, January 1, 1927

	Cash	10250	90		
	Accounts Receivable	14150	20		
	Reserve for Doubtful Accounts			283	00
	Notes Receivable	2550	00		
	Inventory	18234	20		
	Land	25000	00		
	Building	75000	00		
	Res. for Depr. of Building			13500	00
	Office Equipment	5750	00		
	Res. for Depr. of Office Equip.			1325	00
	Warehouse Equipment	3410	00		
	Res. for Depr. of Warehouse Equip.			986	40
	Delivery Equipment	2400	00		
	Res. for Depr. of Delivery Equip.			1080	00
	Investments	5000	00		
	Insurance Prepaid	225	00		
	Advances to Salesmen	75	00		
	Mortgage Payable			26000	00
	Accounts Payable			12290	45
	Notes Payable			4000	00
	E. M. Harvey, Capital			101935	65
	Delivery Expenses	280	00		
	General Office Expenses	72	00		
	Interest Expense	5	00	12	50
	Interest Income	9	20	8	50
	Real Estate Expense			805	00
	Income from Investments	75	00		
	Salaries and Wages			260	00
		162486	50	162486	50

EXERCISE 19-a

Prepare closing journal entries for W. B. Whitney from profit and loss statement called for in Exercise 18-b. Use Cost of Sales method of closing the trading items.

EXERCISE 19-b

Prepare closing journal entries for J. L. Rice from profit and loss statement called for in Exercise 18-c. Use Trading method of closing trading items.

EXERCISE 19-c

From the statement of J. W. Gale called for in Exercise 18-d prepare the following:
(*a*) Closing entries — Trading method
(*b*) Reversing entries
(*c*) Post-closing trial balance

EXERCISE 19-d

From the statement of C. J. Burns called for in Exercise 18-e prepare the following:
(*a*) Closing entries — Trading method
(*b*) Reversing entries
(*c*) Post-closing trial balance

EXERCISE 19-e

H. Young
Trial Balance, December 31, 19—

Cash	$ 2,500.00	
Notes Receivable	2,500.00	
Accounts Receivable	9,500.00	
Real Estate	15,000.00	
Furniture and Fixtures	1,760.00	
Auto Trucks	3,500.00	
Merchandise Inventory, January 1, 19—	7,500.00	
H. Young, Drawing	1,100.00	
H. Young, Capital		$ 20,000.00
Notes Payable		6,000.00
Accounts Payable		4,405.00
Mortgage Payable		8,000.00
Purchases	42,000.00	1,000.00
Sales	1,200.00	72,590.00
Freight In	2,500.00	
Selling Expense	9,600.00	
General Administrative Expense	8,050.00	
Delivery Expense	4,200.00	
Real Estate Expense	1,450.00	
Interest Expense	210.00	
Sales Discount	359.00	
Purchases Discount		875.00
Interest Income		59.00
	$112,929.00	$112,929.00

The following data will be considered in making financial statements:

(1) Inventories:

Merchandise	$8,200.00
Office Supplies	250.00

(2) Interest Accruals:

Notes Receivable	15.00
Notes Payable	30.00
Mortgage Payable	300.00

(3) Depreciation:

Real Estate	2%
Furniture and Fixtures	10%
Auto Trucks	20%

Required:

(*a*) Adjustment journal entries.

(*b*) Work Sheet — eight columns as follows:

Trial Balance	Debit and Credit
Adjustments	Debit and Credit
Profit and Loss	Expense and Income
Balance Sheet	Assets, and Liabilities and Capital

(*c*) Balance sheet.

(*d*) Profit and loss statement — with percentages.

(*e*) Closing journal entries.

(*f*) Reversing entries under date of January 1 to close all accounts that will not be used as current accounts during the ensuing fiscal period.

(*g*) Post-closing trial balance.

QUESTIONS FOR DISCUSSION

1. What is the purpose of the closing journal entries?
2. After the closing entries have been posted to the ledger, what is the effect upon the nominal accounts?
3. In what particular does the Trading method of closing differ from the Cost of Sales method?
4. What is used as a basis for the preparation of the closing entries?
5. In what order should the closing entries be made?
6. Is it necessary to refer to the ledger accounts in preparing the journal entries?
7. What is the purpose of the reversing journal entries?
8. Are all adjustment entries reversed? Explain.
9. Explain the purpose of the post-closing trial balance.
10. Would the proprietor of the business be interested in examining a copy of the post-closing trial balance?
11. Are closing entries necessary each time the financial statements are prepared?

SUMMARY OF CHAPTERS XV–XIX

The current trial balance is analyzed to determine which items need correcting. From this analysis a schedule of adjustments is prepared. The schedule of adjustments is then journalized in regular journal form and posted to the ledger, if the books are to be closed, or to a work sheet if the books are not to be closed. In preparing adjustment entries the accounts appearing in the current trial balance are used as far as possible.

The work sheet serves the purpose of analyzing the trial balance and proving the mathematical correctness of the statements. It also takes the place of the ledger when monthly financial statements are desired and the books are not to be closed. After recording the current trial balance and adjustments and making proper extensions, the various columns are footed and balanced. The balance of the Trading columns represents *gross* profit or loss and is carried to the Profit and Loss columns. The balance of these columns represents *net* profit or loss and is carried to the Balance Sheet columns.

The balance sheet is set up in standard form from data contained in the Balance Sheet columns of the work sheet. The assets are classified as Current Assets, Investments, Fixed Assets, and Deferred Charges. The liabilities are classified as Current Liabilities, Deferred Income, and Fixed Liabilities. The balance sheet is arranged so as to make it as readable as possible. The profit and loss statement is next prepared from the Trading and Profit and Loss columns of the work sheet. The nominal items in these columns are classified as Trading, Operating Expenses, Non-operating Income, and Non-operating Expenses, a separate section being prepared for each group. Operating Expenses may be shown in detail; in detail grouped under sub-headings of selling, administrative, etc.; or in group totals only which are then supported by separate schedules showing details.

Closing entries are prepared from the profit and loss statement in the order in which the items appear in that statement. A Trading account is opened in the ledger to which all merchandise or trading items are transferred. The Trading account is then closed into Profit and Loss account. The operating and other expense and other income items are all closed into Profit and Loss account, after which that account is closed into the proprietor's Current account. The balance of the Current account is then transferred to the Capital account.

Reversing entries are made to close all adjustment accounts so that only current accounts remain open in the ledger during the period. A post-closing trial balance is then taken to make sure that the ledger is in balance before starting the new period.

PARTNERSHIPS

CHAPTER XX

NATURE AND FORMATION OF A PARTNERSHIP

Types of Business Organization. — There are three types of legal organization under which a business enterprise may be conducted — the *individual proprietorship*, the *partnership*, and the *corporation*. The partnership type is usually referred to as a *firm* and the corporation as a *company*. Under the individual proprietorship the business is owned by *one* person; under the partnership, by *two* or *more* persons acting under a verbal or written agreement; under the corporation, by *three* or *more* persons acting under provisions established by law. The working organization of a business, which has to do with the running of the office, the keeping of the books, etc., need differ very little whether the business is owned by an individual, a partnership or a corporation. Thus far this course has dealt only with the accounts of an individual proprietorship. The special features that apply to the accounts of a partnership are discussed in this chapter and those immediately following; the accounts peculiar to corporations are considered in later chapters.

Partnership Defined. — Partnership is the relationship existing between two or more persons who have combined their property, labor and skill, or any of them, for the purpose of conducting a business enterprise for their mutual profit. The parties who enter into this agreement are known as partners. It is not necessary that each partner contribute capital in the form of money or property. One or more of the partners may be skilled mechanics or engineers who contribute their time, labor, and skill, while other partners contribute the financial backing for the firm. The principal reason for the formation of a partnership is to secure a larger amount of capital than is possible under individual proprietorship. Two or three individuals, each having a small amount of capital, are able by combining their funds to provide better equipment and larger working capital for a business. The enterprise can expand, therefore, and grow more rapidly, thus making larger profits than is possible without combined resources. Another important reason for forming a partnership is to secure the services of a person who has outstanding ability as a salesman, engineer, organizer, etc.

Special Partnership Features. — *Mutual Agency.* — In an ordinary partnership each partner may act as a general agent for the firm and have an equal right in the control of the business, irrespective of the amount of capital he has invested. The other partners are bound by his acts along the line of partnership business.

Limited Life. — As the partnership relation is a personal one it is of limited duration. The partnership contract usually specifies the length of time the firm is to exist; otherwise it continues at the will and mutual consent of the partners. Death or retirement of a partner automatically dissolves the partnership. A new partner cannot be admitted without the consent of the existing partners and then only upon the formation of a new partnership.

Full Debt Liability. — Each of the partners is liable under the law for all the debts contracted by the partnership. The private property of each partner may be seized to pay partnership obligations. If the debts are collected from one partner he can compel the others to contribute their share in proportion to their investment should they acquire property.

Not a Legal Unit. — In the eyes of the law a partnership is a collection of individual persons. The firm has no legal existence separate and distinct from the members who compose it. The partners sue and are sued as individuals and not as a firm. For convenience in transacting business ordinary business papers are made out in the firm name and correspondence is carried on in that name, but formal contracts must be entered into as individuals. For that reason there is no common capital account in the ledger. Property is held jointly in the name of the partners.

Limited Partnership. — In a limited partnership, which is formed in accordance with the legal provisions of the various states, many of the above provisions may be modified as to certain partners who then become *limited partners*, the other partners being known as *general partners*.

Articles of Copartnership. — The partnership agreement may be made verbally or in writing. When reduced to writing the written agreement is known as *articles of copartnership*. It sets forth the terms and conditions under which the partnership is formed and establishes rules for its conduct. The written contract is much better than the oral one for the reason that there is less likelihood of misunderstanding, especially in the matter of winding up the affairs of the partnership. When there is no agreement, the law provides how such matters shall be handled; and this may not be in accordance with the intentions of the partners. An illustrative form of Articles of Copartnership containing a number of important provisions is shown on page 167.

ARTICLES OF COPARTNERSHIP

ARTICLES OF AGREEMENT made and entered into this twenty-fifth day of April in the year one thousand nine hundred and twenty-seven, by and between G. L. Roberts and A. L. Walker, both of the City of Boston, County of Suffolk, and the State of Massachusetts.

WITNESSETH:

First	The parties above named hereby agree to associate together as partners under the firm name of Roberts and Walker for the purpose of carrying on the business of a retail book and stationery store at 520 Congress Street in the City of Boston, Massachusetts.
Second	The said partnership shall commence on the first day of June, 1927, and shall continue for a term of five years from that date unless terminated sooner by mutual agreement of the said partners.
Third	The capital investment of each partner shall be the sum of twenty-five hundred dollars ($2,500) in cash.
Fourth	That G. L. Roberts and A. L. Walker shall each be allowed to draw a salary of $50 weekly in cash or merchandise.
Fifth	That each partner may draw out of the business an amount not exceeding $1,500 per annum in addition to salary in anticipation of profits.
Sixth	It is agreed between the parties to this agreement that at all times during the continuance of the said partnership each of them will devote his entire time and utmost skill and power to the development of the business.
Seventh	It is also agreed that all gains, profits, and increase that shall come from said business shall be divided between them equally, and that all losses shall be borne in the same ratio.
Eighth	It is further agreed by and between the said parties that there shall be kept at all times during the continuance of the said partnership full and correct books of account which are to be open for the inspection of each partner; and that the said books shall be closed on June 30 and December 31 of each year and the profit or loss ascertained and transferred to the partners' capital accounts.
Ninth	It is further agreed that during the continuance of the said partnership neither of the said partners shall endorse any note or otherwise become surety for any person or persons without the consent of the other partner.
Tenth	At the end of the partnership period specified above, or upon dissolution by mutual agreement, the books shall be closed and after payment of all liabilities the remaining assets shall be divided between the partners in capital ratio.

IN WITNESS WHEREOF the parties have hereunto set their hands and seals, the day and year first above written.

Signed:

Attest:

Kermit D. Browne

G. L. Roberts

A. L. Walker

The following are some of the provisions that should be included in the articles of copartnership:

(*a*) Date of formation, duration, and conditions under which it may be terminated.

(*b*) Names and addresses of the partners.

(*c*) Name of the firm, and nature and location of the business.
(*d*) Capital invested, and the amount and nature of each partner's investment.
(*e*) How profits are to be shared and losses borne.
(*f*) Provision regarding drawings and salaries.
(*g*) How books of account are to be kept and when accounting is to be made.
(*h*) The part that each partner is to take in the management of the business.
(*i*) Any special agreements regarding endorsing paper for the firm, etc.
(*j*) Procedure in case of dissolution.

Legal Provisions Regarding Partnerships. — When articles of agreement have not been drawn up and where there is no specific agreement regarding the matter, the law provides as follows:

(*a*) Profits or losses will be shared equally.
(*b*) Salaries for services rendered cannot be claimed by partners.
(*c*) Interest on investment cannot be allowed.
(*d*) Interest on drawings cannot be charged.
(*e*) Upon dissolution, after paying outside debts, and partners' loans and capital, the remaining assets will be shared equally.

All of these provisions may be changed by agreement of the partners.

Accounting Features Peculiar to Partnerships. — The bookkeeping principles already learned apply as well to the accounts of a partnership as they do to those of an individual proprietorship. There need be little change in the accounts due to the partnership relation. The same books are used and the bulk of the transactions are recorded in the usual manner. Any slight difference comes in connection with the capital accounts. Since the law recognizes the partners only as individuals, it is necessary to have as many capital accounts as there are partners. This involves some change and variation in recording the formation of the firm. The form of the opening entry depends upon the following conditions:

(*a*) whether the partners invest a definite amount of money or property;
(*b*) whether an individual proprietorship is changed to a partnership; or
(*c*) whether a new partner is admitted to a partnership already in existence.

During the period a partner may lend money to the firm, increase or decrease his investment, or draw out cash or property for personal use against prospective earnings. The firm may settle personal obligations of a partner, etc.

At the *end of the fiscal period* there is the matter of a division of profits, the allowance of interest on capital, the charge for interest on drawings, interest on partners' loans, and in some instances the handling of partners' life insurance.

At the termination of the partnership a number of problems arise in connection with settling up the affairs of the firm, such as distributing the proceeds of liquidation to the partners and closing the partnership books. The bookkeeping procedure depends upon the following conditions:

(*a*) whether the business is to be continued and is sold as a whole, the buyer assuming the obligations of the partnership; or

(*b*) whether the detailed assets are sold by the firm and the obligations paid off.

Ledger Accounts with Partners. — In order to keep a record of each partner's interest in the firm a capital or investment account must be kept with each partner. It is also customary to keep a personal account with each partner. Just as a capital and a current account were kept with the proprietor of an individual business, so are capital and current accounts kept with each partner in a partnership. There will, therefore, be as many capital and current accounts as there are partners. These accounts will be kept in accordance with the principles governing the capital accounts of an individual proprietor with which the student is already familiar.

The Capital Account. — This account is credited with the original investment, with additional investments, and with the profits left in the business. It is charged with any reduction in capital through assumption of a partner's liabilities by the firm, withdrawal of capital, or proportion of losses sustained by the business. The balance represents the net investment.

Current Account. — A partner's personal account is variously known as *Drawings* or *Current* account. This account is used to record the current transactions of the partner with the firm. It is charged with small sums withdrawn from the business, with interest on drawings, and with a share of the losses. It is credited with a share of the profits of the business, with interest on investment, and in some cases with a salary allowance. The balance represents the net change in the partner's capital during the period. The partners may agree to treat this balance as an addition to or a deduction from capital, in which case it is transferred to the Capital account. If desired the balance may be carried forward into the next period.

Salaries and Loans. When it is agreed that a partner shall be allowed a salary against which he is permitted to draw at irregular intervals, the Current account should be credited with the salary allowance and charged with such drawings. A partner may advance funds to the firm to be considered as a temporary loan and not an investment. This may be credited to the Capital account.

In case of dissolution of the partnership, loans and salaries must be paid off before the regular capital is returned to the partners. For that reason these items are frequently recorded in separate Loan and Salary accounts. When this is done, it is possible to have four accounts with each partner — *Capital*, *Current*, *Loan*, and *Salary*. Generally, only two accounts are kept.

Opening Entries for Partnership. — The method of preparing opening entries for a partnership is about the same as that for an individual proprietorship. Each partner is credited with the assets invested. If the investment consists of cash only, the entry is made in the Cash Receipts Journal with detailed information in the General Journal to which cross reference should be made. The following illustration indicates how the record is made:

GENERAL JOURNAL

		January 1, 19--			1
		G. L. Roberts and A. L. Walker of Boston, Mass., have on this date, in accordance with the terms of a written agreement signed by both partners, formed a partnership to conduct a book and stationery store at 520 Congress Street, Boston, Mass., under the firm name of Roberts and Walker. Each partner invests $2,500 cash. Profits and losses are to be shared equally. Each partner is to be allowed a salary of $50 weekly. See Cash Receipts Journal, page 2.			

CASH RECEIPTS

2

Date		L. F.	Account Cr.	Particulars	Amount		Total
19--							
Jan.	1		G.L.Roberts, Cap.	Invest.--See G.J. 1	2500	00	
	1		A.L.Walker, Cap.	Invest.--See G.J. 1	2500	00	

Frequently partners assign to the firm miscellaneous assets as a part of their investment and the firm agrees to assume the payment of certain of the partners' personal obligations. In such cases the procedure is as follows: In one

entry debit each asset and credit the partners' capital account for the sum of the assets turned over to the firm. In another entry credit each liability assumed by the firm and debit the partners' capital accounts for their sum. Thus, there are two entries for each partner from whom both assets and liabilities are taken over. This gives proper information for the ledger accounts. In such cases the cash invested is entered in both the Cash Receipts Journal and the General Journal, and the amount checked in both books to avoid double posting as shown in the illustrations, pages 171 and 172.

GENERAL JOURNAL

July 1, 19-- *1*

	C. E. Curtis and A. B. Brooks of Rochester, New York, have this date entered into a partnership for the purpose of conducting an automobile sales agency at 250 Grand Avenue, Rochester, New York, under the firm name of Curtis and Brooks. Under the terms of the articles of copartnership signed by the partners, each partner transfers to the firm certain assets and the firm assumes certain liabilities as set forth below. Profits and losses are to be shared two-thirds by Mr. Curtis and one-third by Mr. Brooks. Each partner is permitted to draw against profits not to exceed $60 weekly for personal use. The building at 250 Grand Avenue is leased at $300 monthly payable in advance on the first of each month.				
	1				
✓	Cash	1200	00		
	Notes Receivable	2400	00		
	Accounts Receivable	850	00		
	Automobiles (new)	8210	00		
	Auto Supplies	250	00		
	C. E. Curtis, Capital			12910	00

GENERAL JOURNAL (Cont.)

		C. E. Curtis, Capital		2910	00		
		Notes Payable				2000	00
		Accounts Payable				910	00
		To record assets taken over from and liabilities assumed for Mr. Curtis as per agreement. See Cash Book, page 2.					
			1				
✓		Cash		500	00		
		Notes Receivable		1200	00		
		Accounts Receivable		420	00		
		Used Cars		2380	00		
		Garage Equipment		2000	00		
		A. B. Brooks, Capital				6500	00
		A. B. Brooks, Capital		1500	00		
		Accounts Payable				1500	00
		To record assets taken over from and liabilities assumed for Mr. Brooks as per agreement. See Cash Book, page 2.					

CASH RECEIPTS

2

Date	L. F.	Account Cr.	Particulars	Amount	Total
19--					
July 1	✓	C.E.Curtis, Cap.	Invest.--See G.J. 1	1200 00	
1	✓	A.B.Brooks, Cap.	Invest.--See G.J. 1	500 00	

The explanation for the opening entry should receive particular attention. This appears at the top of the page and contains the names of the various partners, the time of beginning the business, the name of the firm, location, kind of business, etc., as shown in the foregoing illustration. It is well to state also how profits and losses are to be divided, the amount of salaries to be paid partners, and any other information that may be of value to the bookkeeper in keeping the accounts properly. It is not necessary, however, to include all the details of the articles of copartnership.

When new books are not to be opened but the books of one of the partners are to be used, the old books are changed to a partnership basis by writing the explanation in the journal and making the entry for the other partner the

same as before. However, it is not necessary to make an entry for the partner whose books are being used, unless his accounts are to be adjusted or he makes an additional investment.

EXERCISE 20-a

On January 1, 19— James Allan's capital account showed a balance of $8,530, while that of C. T. Strong showed a balance of $4,540. On July 15 Allan made an additional investment of $1,500 while Strong reduced his investment $1,000. The drawings of the partners against prospective profits were as follows:

Allan —	June 1	$500.00	Strong —	April 15	$250.00
	Aug. 10	200.00		Oct. 1	600.00
	Nov. 15	700.00			

On September 10 the firm paid a personal note of Strong's amounting to $150. At the end of the year the profit is $6,750, which is to be shared — Allan, two-thirds; Strong, one-third.

Required:

(*a*) Set up in T ledger form Capital and Current accounts for each partner and insert the above items in the proper accounts.

(*b*) Prepare journal entries to divide the net profits and to close the Current accounts.

(*c*) Post the above entries and rule up the accounts.

EXERCISE 20-b

A. B. Harlan and G. T. Lowe form a partnership to conduct a jobbing business. On January 1, 19— Harlan invests $15,000 and Lowe invests $10,000. Profits and losses are to be shared in proportion to capital invested. Harlan is to be credited with a monthly salary of $300 and Lowe with a monthly salary of $250. On September 1 additional investments are made as follows: Harlan, $3,000 and Lowe, $2,000. On December 1, the firm being badly in need of funds, Harlan advances $2,000 as a temporary loan. During the year Harlan has drawn salary amounting to $3,000; Lowe, $3,200. Personal bills of partners were paid and charged to current accounts as follows: Harlan, $200; Lowe, $450. The profit for the year is $12,000.

Required:

(*a*) Set up T ledger accounts for Capital, Current and Salary accounts for each partner and enter the above items directly in the proper ledger accounts.

(*b*) Prepare journal entries to divide the net profits, to close the balances of the salary accounts to the current accounts, and to close the current accounts into capital.

(*c*) Post the above entries and rule the accounts.

EXERCISE 20-c

On January 1, 19— T. A. Collins and Robert Cullis formed a partnership to conduct a grocery business at 450 Main Street, Cincinnati, Ohio, under the firm name

of T. A. Collins & Co. Profits and losses are to be shared equally. The investments are as follows: T. A. Collins: Cash for $10,000; store equipment, $3,500; notes in his favor endorsed to the firm at face value, $900; stock of groceries, $4,500. Robert Cullis: his personal check for $1,200; store building valued at $18,000.

Required:

Prepare the necessary entries in the journals to open the books of the new firm.

EXERCISE 20-d

On June 1, 19— C. D. Cook and R. N. Harris, each of whom has been engaged in a small trucking business, decide to form a partnership to continue in the same line of business under the firm name of Cook and Harris. Profits and losses are to be divided in proportion to investments and each partner is to be permitted to draw $75 per week for personal expenses. Cook's assets and liabilities are as follows: Cash, $1,000; two trucks valued at $2,400; supplies valued at $125; accounts due from customers, $960; notes payable, $500; an account due North Side Garage, $160. Harris's assets and liabilities are as follows: Cash, $800; real estate valued at $15,000 subject to a mortgage for $8,000; truck valued at $900; office equipment valued at $450; notes payable, $300.

Required:

Prepare necessary entries to open the partnership books, giving full particulars.

EXERCISE 20-e

On January 1, 19— Geo. Gordon and H. C. Hunter formed a partnership, Gordon investing $8,000 in cash and Hunter, $7,000. They agreed to share profits and losses equally. During the year they bought goods on account, $15,000. They sold goods on account, $12,000, and for cash $8,000. Their expenses for the year were $1,500. They paid $10,000 on accounts payable and issued notes for $2,500. They collected $10,500 from customers and took notes for $1,200. During the year Gordon withdrew $800 and Hunter $600. The goods on hand at the end of the year were $3,500.

Required:

(*a*) Opening entry and summary journal entries for transactions for the year.

(*b*) Post the journal entries to ledger accounts and prepare a trial balance.

(*c*) Prepare closing journal entries, post, and close ledger.

EXERCISE 20-f

T. B. Rice and O. R. Wilde of Newport, R. I., form a partnership on July 1, 19— to conduct a garage business at 260 Federal Street under the firm name of Rice and Wilde. They agree to invest $15,000 each and share profits equally. Rice has been conducting a garage for some time but wishes more capital so that he can take on an automobile agency and do an auto livery business. He, therefore, turns over to the firm as a part of his investment his business at a net worth of $12,200 as shown by the following trial balance, and gives his personal check for the balance:

Trial Balance, July 1, 19—		
Cash	$ 1,860.00	
Accounts Receivable — Storage	450.00	
Accounts Receivable — Supplies	90.00	
Garage Building	25,000.00	
Garage Equipment	1,800.00	
Mortgage Payable		$15,000.00
Notes Payable		1,200.00
Accounts Payable		800.00
T. B. Rice, Capital		12,200.00
	$29,200.00	$29,200.00

O. R. Wilde invests livery autos valued at $7,500; a 6% interest-bearing note for $1,500, dated June 1, 19—, at three months and signed by L. C. Smith. The note is taken over at its bank discount value and Wilde gives his check for the balance of his investment.

Required:

(*a*) Prepare entries in proper form as they would appear in the journals assuming that new books are not to be used but that Rice's set of books is to be continued.

(*b*) Open ledger accounts for items in Rice's ledger and insert balances. Post the entries and prepare a trial balance of the new firm.

EXERCISE 20-g

A and B, who had hitherto been in business separately, decided to enter into partnership on July 1, 19—. The balance sheets of A and B were on that date as follows:

A

Assets		Liabilities	
Furniture	$ 750.00	Accounts Payable	$1,000.00
Accounts Receivable (face value)	2,500.00	Capital Account	5,000.00
Merchandise	2,550.00		
Cash	200.00		
	$6,000.00		$6,000.00

B

Furniture	$ 600.00	Accounts Payable	$1,500.00
Accounts Receivable (face value)	1,500.00	Capital Account	3,000.00
Merchandise	2,000.00		
Cash	400.00		
	$4,500.00		$4,500.00

It was agreed that A and B should adjust their respective accounts receivable at $200 and $150 less than the face values shown in the balance sheets, these amounts to be charged against their capital accounts and carried on the partnership books as a reserve for doubtful accounts. With the above exceptions the assets and liabilities of the parties were to be taken over by the partnership at the balance sheet figures, and B was to invest in the partnership in cash a sum which, after making the adjustments above referred to, would make his capital account the same as that of A.

Required:

(*a*) Prepare journal entries to open the books of the new firm.

(*b*) Submit trial balance of the new firm.

EXERCISE 20-h

B. A. Mitten and Robert C. Drake, competitors in the provision business, decide to form a partnership to continue a provision business at the location formerly occupied by Mitten at 30 Broadway, Somerville, Mass. Profits are to be shared equally and each partner is to be permitted to draw $50 weekly.

The balance sheets of the respective partners at the time of consolidation are as follows:

B. A. Mitten

Balance Sheet, June 30, 19—

Assets		Liabilities	
Cash	$3,745.20	Accounts Payable	$2,642.80
Accounts Receivable	2,984.12	Mortgage Payable	5,000.00
Merchandise Inventory	3,245.10	Notes Payable	2,500.00
Store Equipment	3,400.00	B. A. Mitten, Capital	15,231.62
Delivery Equipment	3,000.00		
Real Estate	9,000.00		
	$25,374.42		$25,374.42

Robert C. Drake

Balance Sheet, June 30, 19—

Cash	$ 1,485.20	Accounts Payable	$2,150.00
Accounts Receivable	2,645.00	Notes Payable	500.00
Notes Receivable	1,200.00	Robert C. Drake, Capital	12,450.50
Merchandise Inventory	6,420.30		
Store Equipment	2,400.00		
Delivery Equipment	950.00		
	15,100.50		$15,100.50

It is agreed that each partner shall write down his merchandise inventory 10%; that provision for loss of customers' accounts shall be made on the basis of 5% of

Mitten's customers' balances, and 3% of those of Drake; that reserves for depreciation shall be provided by each partner on Store Equipment 20%, delivery equipment 40%; and that the real estate and mortgage of Mitten shall be retained by him and not turned over to the firm. The building is rented to the firm at $100 per month. After making these adjustments each partner agrees to invest enough cash from his personal funds to make his investment $12,000.

Required:

(*a*) Entries in the General Journal to open the books of the firm. (Assume that new books are to be opened.)

(*b*) Balance sheet, after formation of the partnership.

QUESTIONS FOR DISCUSSION

1. Name the three types of legal organization under which a business may be conducted and point out their chief difference.

2. In what way does the working organization of a business differ from its legal organization?

3. Define a partnership.

4. A is a skilled mechanic who has invented a new electrical device but he has no capital. B is a retired business man who is quite wealthy. How would it be possible for them to form a partnership and of what would the investment of each consist?

5. Name the principal reasons why partnerships are formed.

6. Explain each of the following terms as applied to partnerships: (a) mutual agency, (b) limited life, (c) full debt liability, (d) legal entity.

7. In what particular does a limited partner differ from a general partner?

8. What is meant by the term "Articles of Copartnership"? Name some of the items that should be included in this document.

9. Why is it better to have the agreement to form a partnership in writing?

10. What does the law have to say about division of profits, salaries, and allowances for interest when no agreement is made regarding these items?

11. Is it necessary to learn a new system of bookkeeping in order to keep the accounts of a partnership? Explain.

12. Name some special bookkeeping problems connected with partnerships.

13. Name accounts usually kept with each partner and give their functions.

14. What special treatment is sometimes given to the handling of salaries and loans of partners?

15. In what particular do the opening entries for partnerships differ from ordinary journal entries?

16. Assuming that three accounts are kept with each partner, to which should the following items be charged: Reduction in investment; firm pays a note of a partner; drawing of salary; drawing of prospective profits?

CHAPTER XXI

ADMISSION AND WITHDRAWAL OF A PARTNER

Changing Individual Proprietorship to Partnership. — Where a partnership is formed to continue the business owned by an individual proprietor the owner of the business usually enters into a partnership to secure additional cash capital, or to secure the assistance of a partner in the management of the business.

The amount that the incoming partner pays for his interest does not always depend upon the net worth of the business as shown by the bookkeeping records. Usually the agreement is that the incoming partner shall receive a definite interest, such as one-third or one-half of the business, and the capital is adjusted accordingly. For instance, Thomas Perry owns a business which has a net worth of $12,000. He needs additional working capital and agrees to accept A. T. Jones as an equal partner, provided he *invests* an amount equal to Perry's net worth. The entry to record Jones' investment is made as in the previous chapter, the debits and credits being as follows:

Cash	$12,000.00	
A. T. Jones, Investment		$12,000.00

Proper explanation regarding the formation of the partnership is made in the General Journal, and Jones is credited for his investment in the Cash Receipts Journal.

On the other hand, Perry may have sufficient capital for his business but desires to find someone who will share the management of the business with him. In such a case he may *sell* Jones a one-half interest in his business. Jones pays $6,000 for his interest; the money is retained by Perry personally and does not appear on the books. The only entry necessary is to adjust the capital so that the books will show the share held by each partner. The following entry is made:

Thomas Perry, Capital	$6,000.00	
A. T. Jones, Capital		$6,000.00

This entry appears in the General Journal with proper explanations regarding the formation of the partnership.

From the foregoing it is seen that a distinction must be made between *investing*

in the business in order to secure an interest and *purchasing* an interest in a *going* business from the present owner. In the first instance Jones' money goes into the business and the capital is increased by the amount he contributes. In the second instance Jones' money goes to Perry personally and the capital of the business is not increased but is divided so that each partner owns one-half, or $6,000.

Admission of Partner to Existing Partnership. — Upon the unanimous consent of the existing partners in a partnership a new partner may be admitted at any time. This, however, has the effect of dissolving the old partnership and forming a new one. A record of the conditions under which the new partner is admitted is made in the General Journal. The same principles apply to the handling of the investment of the new partner in this case as in the foregoing illustration. For instance, Thomas Perry and George Price are equal partners, the net worth of each being $12,000; A. T. Jones *invests* sufficient to entitle him to a one-third interest, or $12,000. The entry is as follows:

Cash	$12,000.00	
A. T. Jones, Capital		$12,000.00

If, however, it is agreed that Jones shall *buy* a one-third interest from the old partners the entry is as follows:

Thomas Perry, Capital	$4,000.00	
George Price, Capital	4,000.00	
A. T. Jones, Capital		$8,000.00

Each of the old partners is reimbursed for the capital transferred to Jones, Perry taking $4,000 of the cash paid by Jones, and Price $4,000.

Goodwill. — In the foregoing illustrations, both the *investment* to secure an interest and the *purchase* of an interest were based on the value of the business as shown by the books of the owners, known as *book value.* Sometimes a value in excess of the so-called book value is used as a basis for determining the amount the new partner must pay, in which case an element called *goodwill* must be considered.

In the first illustration on page 178 assume that A. T. Jones agrees to invest $15,000 for one-half interest. This indicates that he considers Perry's business worth more than $12,000. He values the net assets at $3,000 more than the value shown on the books. This assumed value may be due to the standing, reputation, advertising, location, earning power, etc., of the business and is an intangible asset known as *goodwill.*

Goodwill has been defined as " the value of the benefits or advantages which

attach to a particular business in addition to the actual value of the property used in its conduct." When such goodwill has actual value, it may be recorded as an asset on the books at the time it is purchased or sold and represents an addition to the capital of the original owner of the business, whether that be an individual owner or a partnership. The bookkeeping entry for Jones' investment is as follows:

Goodwill	$ 3,000.00	
Thomas Perry, Capital		$ 3,000.00
Cash	15,000.00	
A. T. Jones, Capital		15,000.00

The recording of goodwill on the books and its later disposition is largely a matter of agreement among the partners. It may be written off over a period of years, or it may be retained on the books at its original value. In the case of a partnership, goodwill is divided among the old partners in the same proportion in which they share profits and losses, without reference to their capital ratios.

Referring to the illustration on page 179, assume that A. T. Jones invests $15,000 and that Thomas Perry and George Price share profits equally. The entries are as follows:

Goodwill	$ 6,000.00	
Thomas Perry, Capital		$ 3,000.00
George Price, Capital		3,000.00
Cash	15,000.00	
A. T. Jones, Capital		15,000.00

Also, when an incoming partner *buys* an interest in a business and his money goes to the original owners, he may pay more than book value; in which case goodwill may be recorded on the books if the partners so agree. When goodwill is not recorded, the entry to adjust capital is the same as when an interest in the business is sold at book value, as illustrated on page 179. The partners are reimbursed for capital given up and the amount paid for goodwill is divided among the partners in their profit and loss ratio.

Valuation of Goodwill. — There is no definite rule for estimating the value of the goodwill of a going business. It is usually the difference between the amount paid for a business and the value of the net assets as shown by the books. Thus, if the purchase price is based upon a valuation of $25,000 and the net assets as shown by the books or upon appraisal amount to $20,000, the difference is construed to represent goodwill.

Another method is to agree upon the value of the net assets as shown by the books and then set a definite price on the goodwill. This is known as the *set price* method.

A common method is to base goodwill upon the earning power of the concern. It may be so many times the average profits. Or, the average profits for a term of years, usually from three to five, may be capitalized at what is agreed upon as a fair return upon the investment. The difference between such capitalization and that shown by the books is considered as goodwill. Assume that the average profits of a business amount to $5,000. This amount capitalized at 10% amounts to $50,000. If the capitalization as shown by the books amounts to $40,000 the difference, or $10,000, represents the value of goodwill.

Securing an Interest at Less than Book Value. — Sometimes the amount the new partner invests or pays is based upon less than the value shown on the books. This has just the opposite effect of goodwill. Instead of there being a profit or addition to the capital of the original owners, there is a loss or reduction in such capital. Assume that A. T. Jones agrees to invest $10,000 in Thomas Perry's business; then it is necessary for Perry to adjust his capital by writing down some asset and charging his capital account. The entry may be as follows:

Thomas Perry, Capital	$ 2,000.00	
Reserve for Doubtful Accounts		$ 2,000.00
Cash	10,000.00	
A. T. Jones, Capital		10,000.00

Withdrawal or Death of a Partner. — A partner may withdraw from the firm at any time with the consent of the other partners. This has the effect of dissolving the partnership and a new agreement must be prepared by the surviving partners. When a partner withdraws without the consent of the other partners, he is liable to them for any loss that they may suffer because of his withdrawal. Inasmuch as the old partnership is dissolved, it is customary to close the books and ascertain the amount of net capital due each partner so that the withdrawing partner may be paid off. If the partner who withdraws demands a share of the goodwill of the firm, it is necessary to estimate the goodwill and make an entry charging Goodwill and crediting the partners for their share in profit and loss ratio. The withdrawing partner's Capital account is then charged and whatever asset is accepted by him in payment for his interest is credited.

Illustration. — Assume that W. F. Allen, Amos Bennett, and Thos. E.

Crosby are partners in a business and that Crosby decides to withdraw. The books are closed and after closing the partners' Current accounts into their Capital accounts the balances of the latter are as follows: Allen, $22,450; Bennett, $20,150; and Crosby, $18,260. Profits and losses are shared equally. It is estimated that the goodwill of the business is worth $15,000. Crosby agrees to accept in payment of his interest a note for $10,000 and cash for the balance. The entries to record his withdrawal and close his capital account are as follows:

Goodwill	$15,000.00	
W. F. Allen, Capital		$ 5,000.00
Amos Bennett, Capital		5,000.00
Thos. E. Crosby, Capital		5,000.00
Thos. E. Crosby, Capital	23,260.00	
Notes Payable		10,000.00
Cash		13,260.00

In case a partner dies the entries differ from the foregoing only in that the assets are paid to his estate instead of to him personally. In some instances his interest may be sold to another who may, with the consent of the other partners, take the place of the deceased partner. In such a case, the settlement between the new partner and the estate is not recorded on the partnership books; the only entry necessary is to transfer the deceased partner's capital to the new partner's account.

EXERCISE 21-a

The capital account of A. J. Sullivan is credited with $9,000. The business needs more working capital. R. Mannix offers to invest $9,000 in the business for a one-half interest. His offer is accepted and his check for $9,000 is received.

Required:

Entries in Sullivan's books to show formation of partnership and to record Mannix's investment.

EXERCISE 21-b

A. J. Barrows has $10,000 invested in a business. He needs assistance in managing the business and sells a half interest to S. R. Rogers for $5,000, the money not to go into the business but to be retained by Barrows personally.

Required:

Entry to adjust the capital accounts.

EXERCISE 21-c

M. E. Briggs and W. O. Gallagher are partners, having capital balances on De-

cember 31, 19— as follows: Briggs, $8,620; Gallagher, $5,380. F. J. Linton offers to invest $6,000 in the business.

Required:

(*a*) Provided his offer is accepted, what interest in the business should Linton receive, based on the book value of the old firm?

(*b*) Show entry to record his admission.

EXERCISE 21-d

E. E. Creighton and F. W. Bryan are partners in the stationery business. They each have invested $10,000. The profits for the year after deducting all expenses amount to $4,650. After closing the books they admit J. A. Crewill as a partner upon his investing such a sum as will entitle him to a one-third interest in the business.

Required:

(*a*) Find the amount of Crewill's investment.

(*b*) Show entry to record same.

EXERCISE 21-e

A firm is composed of G. T. Wilson and A. H. Wheeler whose capital accounts show balances of $15,000 and $20,000 respectively. They *sell* a one-fifth interest in the business to Geo. Williams at book valuation.

Required:

(*a*) Find the amount Williams must pay.

(*b*) Prepare entries to adjust the accounts.

EXERCISE 21-f

F. W. Watson and H. H. Cramer are partners in a grocery business. On December 31, 19— Watson's capital is $12,000 and Cramer's $18,000. T. E. Ross desires to secure an interest in the business. The old partners place a value of $4,000 on their goodwill. They agree to admit Ross after recording the goodwill.

Required:

(*a*) What amount must Ross invest in order to secure a one-third interest?

(*b*) Prepare journal entries to adjust accounts and show admission of Ross.

EXERCISE 21-g

W. A. Coleman & Co., who conduct a wholesale business, admit R. J. Roberts as an equal partner upon the investment of $25,000 in cash by him. The new firm is to take over the assets and assume the liabilities as shown by the balance sheet of Coleman & Co. as of December 31, 19—.

Balance Sheet, December 31, 19—

Real Estate	$20,000.00	Notes Payable	$10,000.00
Furniture & Fixtures	3,000.00	Accounts Payable	8,700.00

W. A. Coleman & Co. (Cont.)

Inventory	$20,000.00	Taxes Accrued	$ 515.00
Notes Receivable	2,215.00	W. A. Coleman, Capital	20,000.00
Accounts Receivable	9,000.00	Harry Smith, Capital	20,000.00
Cash	5,000.00		
	$59,215.00		$59,215.00

Required:

Journal entries to record the admission of Roberts, the same books to be used.

EXERCISE 21-h

The balance sheet of John Taylor as at December 31, 19— is as follows:

Balance Sheet, December 31, 19—

Assets		Liabilities	
Cash	$ 2,000.00	Accounts Payable	$ 9,000.00
Accounts Receivable	8,000.00	Notes Payable	4,000.00
Notes Receivable	1,000.00	John Taylor, Capital	8,000.00
Inventory	6,000.00		
Buildings	4,000.00		
	$21,000.00		$21,000.00

Taylor enters into an agreement with F. W. Banes whereby Mr. Banes is to invest $12,000 in cash, acquiring thereby a one-half interest in the business. The old books are to be continued. Goodwill is to be brought on the books.

Required:

Show in journal form the necessary entries to adjust the accounts.

EXERCISE 21-i

The books of the firm of Austin & Bennett show the following balance sheet:

Balance Sheet, December 31, 19—

Assets		Liabilities	
Cash	$ 8,000.00	Accounts Payable	$ 2,400.00
Accounts Receivable	4,000.00	B. E. Austin, Capital	8,000.00
Merchandise Inventory	6,000.00	R. G. Bennett, Capital	8,000.00
Furniture and Fixtures	400.00		
	$18,400.00		18,400.00

F. C. Mills buys a one-half interest in the business for $7,000, it being agreed that the inventory shall be adjusted.

Required:

Make entries to admit Mills and adjust the accounts.

EXERCISE 21-j

Three partners, X, Y and Z, go into partnership and pay in as capital $15,000, $10,000, and $5,000 respectively. Profits and losses are shared in capital ratio. At the end of the first year the business shows a profit of $7,500. X withdraws from the firm. An allowance of $2,500 is agreed upon for loss on bad accounts, after which X is paid off in cash and Y and Z take over the business.

Required:

Prepare necessary journal entries to give effect to the above.

QUESTIONS FOR DISCUSSION

1. For what purpose does an individual usually enter into a partnership?
2. Is the amount of money that the incoming partner pays always dependent upon the net worth as shown by the books?
3. What distinction is made between *purchasing* an interest in a going business and *investing* in the business in order to secure an interest?
4. What is the effect upon a partnership when a new partner is admitted to the firm?
5. What is meant by "goodwill"?
6. What is the relation between goodwill and book value?
7. Is goodwill always recorded in the ledger? When so recorded, what is its final disposition?
8. How is the goodwill arising from the sale of an interest in a partnership divided among the partners?
9. Explain the common methods of determining the value of the goodwill of a business.
10. Under what condition do you think an individual or a partnership would be willing to dispose of an interest in the business at less than the value shown on the books?
11. Under what conditions may a partner withdraw from a partnership before the expiration of the partnership agreement? What is the effect of such a withdrawal on the firm?
12. What becomes of a partner's interest in a firm at his death?

CHAPTER XXII

PROFIT SHARING IN PARTNERSHIPS

Methods of Dividing Profits. — As stated in Chapter XX the law provides that where there has been no agreement as to how profits and losses are to be divided, they shall be divided equally among the partners regardless of the amount of their capital investment. In partnerships there is a *capital ratio*, which refers to the interest in or share of the capital owned by each partner, and a *profit and loss ratio*, which refers to the proportion of the profits or losses to be borne by each partner. These ratios may be the same or they may be quite different. If A's capital is $10,000 and B's is $5,000, the capital ratio is 2 to 1 or $\frac{2}{3}$ and $\frac{1}{3}$. The profit and loss ratio may be any ratio agreed upon; in the absence of agreement, however, the division is equal. The law assumes that where there is an unequal investment in capital the partner investing the lesser capital invests skill or ability of some kind to offset the larger capital.

The following are some methods of dividing profits usually agreed upon:

(*a*) In proportion to capital invested at the beginning of the partnership.
(*b*) In proportion to capital invested at the beginning of the fiscal period.
(*c*) In proportion to capital invested at the time of division of profits.
(*d*) In proportion to capital invested, considering the length of time invested.
(*e*) A ratio determined by the amount of time given to the business by a partner, his business connections, mechanical or managerial skill, etc.

Illustration

The capital accounts of A and B, partners, at the end of the year are as follows:

A Capital

						19--					
						Jan.	1	Investment		20000	00
						Nov.	1	Additional investment		5000	00

B Capital

19--						19--					
Nov.	1	Withdrew		5000	00	Jan.	1	Investment		30000	00

The profits for the year are $15,000. How much should each receive? Under (*a*) the profit is divided in investment ratio:

A's investment, $20,000 = $\frac{2}{5}$ of capital
B's investment, 30,000 = $\frac{3}{5}$ of capital
Total investment, $50,000 = $\frac{5}{5}$ of capital

Therefore —

$\frac{2}{5}$ of $15,000, or $ 6,000 = A's share of net profit
$\frac{3}{5}$ of 15,000, or 9,000 = B's share of net profit
$15,000 = Total net profit

When amounts are uneven it is better to use a percentage ratio instead of a common fraction. The investment of each partner is compared with the total to find the percentage each should receive thus:

A's investment, $20,000 = 40% of capital
B's investment, 30,000 = 60% of capital
Total investment, $50,000 = 100% of capital

Therefore —

40% of $15,000, or $ 6,000 = A's share of net profit
60% of 15,000, or 9,000 = B's share of net profit
$15,000 = Total net profit

Under (*b*) the method of calculating how much profit each partner should receive is the same as for (*a*) and in this illustration the result is the same, as the *original investment* is the *investment at the beginning of the period.* Under (*a*) the ratio does not change while under (*b*) the ratio will be affected by subsequent additions or withdrawals of capital.

Under (*c*) the method of calculating is the same as for (*a*) except that the capital at the end of the period is used, so that the figures are:

A's capital at end of period, $25,000 = $\frac{1}{2}$ of total capital
B's capital at end of period, 25,000 = $\frac{1}{2}$ of total capital
Total capital at end of period, $50,000

Therefore —

$\frac{1}{2}$ of $15,000, or $ 7,500 = A's share of net profit
$\frac{1}{2}$ of 15,000, or 7,500 = B's share of net profit
$15,000 = Total net profit

Under (*d*) the credit items of each account are multiplied by the number of months or days invested, and from the total of the products thus found is de-

ducted the sum of the debit items multiplied by the number of months or days withdrawn. The result in each case is the net investment of the partner for one month or day. These amounts are compared to find the profit sharing ratio.

		A	
12	× $20,000	= $240,000	invested for one month
2	× 5,000	= 10,000	invested for one month
		$250,000	invested for one month
		B	
12	× $30,000	= $360,000	invested for one month
Less — 2	× 5,000	= 10,000	withdrawn for one month
		$350,000	invested for one month

A's investment for one month, $250,000 = $\frac{5}{12}$ of total
B's investment for one month, 350,000 = $\frac{7}{12}$ of total
Total investment for one month, $600,000

Therefore —

$\frac{5}{12}$ of $15,000, or $ 6,250 = A's share of net profit
$\frac{7}{12}$ of $15,000, or 8,750 = B's share of net profit
$15,000 = Total net profit

Under (*e*) the ratio is given and it is not necessary to compute it.

Salary Allowances. — Unless expressly agreed upon in the articles of agreement, a partner cannot claim a salary. His capital, time, and services are assumed to be compensated for in the form of net profit. Salary allowances are, therefore, not an expense of the business, but really a part of the net profits of the business distributed to the partners. For bookkeeping purposes salaries are often classified as expenses in order to show the profit the business would return if it were necessary to hire an outsider to perform the work done by the partner.

Illustration. — L. M. Perry and F. C. Jones, partners, are allowed an annual salary of $3,000 and $2,400 respectively. The entry to record the same at the close of each month is as follows:

Partners' Salaries	$450.00	
L. M. Perry, Current		$250.00
F. C. Jones, Current		200.00

The entry for drawings during the period is

L. M. Perry, Current	$225.00	
F. C. Jones, Current	200.00	
Cash		$425.00

The partners' drawings are often limited to the amount of salary allowed.

Interest on Partner's Capital. — Just as salary may be considered as a special distribution of profit in return for services rendered before the general distribution in the agreed ratio, so an allowance of interest on capital invested provides a means of compensating the partner having the larger capital for the use of his excess capital. This adjustment is also made through the partner's current account. The principal reason for allowing interest on capital and charging interest on drawings in excess of salary is to provide a means of making an adjustment of unequal investments, drawings, and division of profits. If the capital ratio and the profit and loss ratio are the same, there is no reason for an interest charge. Interest of this kind is not, therefore, an expense of the business but serves as a capital adjustment. When interest is allowed it is figured from the date of the investment until the end of the period.

Illustration No. 1

J. C. Willis and D. S. Warren, partners, have a combined capital of $50,000 of which Willis contributed $30,000 and Warren $20,000. Interest is to be allowed on their capital balances at 6%, after which the profits are to be divided equally. The profit for the period is $5,000.

Journal entries to adjust the interest:

Profit and Loss	$3,000.00	
J. C. Willis, Current		$1,800.00
D. S. Warren, Current		1,200.00
To credit each partner with interest on his capital for one year at 6%.		
Profit and Loss	2,000.00	
J. C. Willis, Current		1,000.00
D. S. Warren, Current		1,000.00
To distribute the remainder of net profit equally after allowing for interest charge.		

Hence, Willis' share of the profits is $2,800 and Warren's is $2,200.

Illustration No. 2

Sometimes interest on investments and drawings is not passed through the Profit and Loss account but is adjusted directly through the partners' current accounts. The total amount of interest charged or credited to each partner is found and compared with the proportion of the total interest charge each partner must bear in accordance with the basis for sharing profits and losses under the partnership agreement. An entry is then made debiting or crediting each

partner for the proper amount. Using the figures shown in Illustration #1, the adjustment is as follows:

	Total	Willis	Warren
Interest credited to partners	$3,000	$1,800	$1,200
Interest charged according to profit and loss ratio (equally)	3,000	1,500	1,500
		$ 300 Cr.	$ 300 Dr.

Journal entries to adjust the accounts:

D. S. Warren, Current	$300.00	
J. C. Willis, Current		$300.00
To adjust interest on partners' capital accounts.		
Profit and Loss	5,000.00	
J. C. Willis, Current		2,500.00
D. S. Warren, Current		2,500.00
To divide profits equally between partners.		

The result is the same as in Illustration #1 — Willis takes $2,800 of the profits and Warren $2,200.

In preparing the profit and loss statement the normal net profit is found and then the salary and interest charges are deducted to show the profit to be divided according to the agreed ratio.

Insurance on Partner's Life. — The firm frequently takes out life insurance on the lives of the partners in order to protect itself from financial loss in case of their death. When this is done the cost of the insurance premium should be properly handled. If the policy has a cash surrender value, that amount should be carried on the books as an asset as that is the amount the insurance company will return if the policy is cancelled. If the policy has no cash surrender value the cost of the premium should be charged to Insurance Expense. Policies having a cash surrender value contain a table showing the value at the end of each year and this should be the basis for the entry. The entry for the payment of the insurance premium is as follows:

Insurance Expense	xxx xx	
Cash		xxx xx

The cash surrender value does not come into existence until after three annual premiums have been paid, so the first three premiums are charged as above and in order that each fiscal period may be charged with the proper proportion

of expense an entry is made at the end of each of the first three years for one-third of the cash surrender value at the end of the third year, as follows:

Life Insurance Policy	xxx xx	
Insurance Expense		xxx xx

Thereafter, enough of the premium will be charged to the Life Insurance Policy account each year to make the balance agree with the amount of the cash surrender value shown on the policy.

In case of death the amount received from the insurance company is credited to Life Insurance Policy account, the excess being an increase in capital to be divided between the deceased partner's estate and the surviving partners in profit and loss ratio.

Illustration

A firm composed of J. M. Olson and A. S. White insured the life of Olson for $10,000, the policy being made payable to the firm in case of death. The annual premium payable in advance is $195. The cash surrender value at the end of the third year is $450; fourth year, $602; fifth year, $770. Olson dies at the end of the fifth year.

The entries to record the above are as follows:

First Year

Insurance Expense	$195.00	
Cash		$195.00
To record payment of insurance premium on partner's life.		
Life Insurance Policy	150.00	
Insurance Expense		150.00
To record as asset one-third of cash surrender value at end of third year as per policy.		

The same entries are made at the beginning and end of the second and third years.

Fourth Year

Insurance Expense	$195.00	
Cash		$195.00
To record payment of insurance premium on partner's life.		

Life Insurance Policy	$152.00	
Insurance Expense		$152.00
To record increase in cash surrender value of policy.		

Fifth Year

Insurance Expense	195.00	
Cash		195.00
To record payment of insurance premium on partner's life.		
Life Insurance Policy	168.00	
Insurance Expense		168.00
To record increase in cash surrender value of policy.		
Cash	10,000.00	
Life Insurance Policy		770.00
J. M. Olson, Capital (Estate)		4,615.00
A. S. White, Capital		4,615.00
To record payment of insurance at death of J. M. Olson.		

EXERCISE 22-a

The ledger of H. C. Case & Co. shows the following accounts with partners at the end of a fiscal period:

H. C. Case, Capital	$40,000.00	H. C. Case, Current, Cr.	$1,500.00
W. A. Bond, Capital	10,000.00	W. A. Bond, Current, Dr.	1,250.00
F. E. Wise, Capital	20,000.00	F. E. Wise, Current, Dr.	2,500.00

It is agreed that at the close of a fiscal period the balances of partners' current accounts shall be closed into capital. Profits are divided in proportion to the balance of capital accounts before closing, these items not having changed during the year. The profits for the year were $35,000.

Required:

(*a*) Prepare journal entries affecting partners' accounts at the close of the year.

(*b*) Show partners' capital accounts properly ruled at the close of the year after giving effect to the foregoing.

EXERCISE 22-b

The profits of the Ames and Smith Company for the year ending December 31, 19— amount to $12,000. P. T. Ames' investment on January 1, 19— was $40,000 and J. W. Smith's $35,000. On July 1, 19— Ames withdrew $5,000; on June 1, 19— Smith withdrew $10,000.

Required:

Set up proper journal entry to divide the profits under each of the following methods:

(*a*) According to the original investment.

(*b*) According to net investment at the end of the period.

(*c*) According to the average investment.

(See page 188 for method of figuring average investment.)

EXERCISE 22-c

G. O. James and S. F. Wilson form a copartnership on January 1, 19—, each investing $10,000 cash. On April 1 James pays in an additional $2,500 and Wilson draws out $1,500. On August 1 Wilson pays in $3,000 and James withdraws $1,000. The profits for the year ending December 31, 19— are $5,000.

Required:

Prepare ledger accounts showing each partner's investment and portion of profits, the profits being divided in proportion to capital invested and the time it is employed.

EXERCISE 22-d

The articles of copartnership of the firm of Colpitts and Files, automobile supplies, provides that before the net profits for a fiscal period are divided an allowance shall be made for 6% interest on partners' investments and withdrawals for the period, and that the balance shall be divided on the basis of two-thirds for Colpitts and one-third for Files. The net profits for the year 19— were $12,856. The capital accounts of the partners appear as follows at the end of the year 19—:

G. W. Colpitts, Capital

19—				19—			
June	10	2,000	00	Jan.	1	25,000	00
July	20	1,000	00	April	30	5,000	00

H. G. Files, Capital

19—				19—			
Sept.	20	4,000	00	Jan.	1	20,000	00
				Nov.	24	5,000	00

Required:

Show by journal entries the proper division of profits for the year 19— in accordance with the articles of agreement. (Show method of computation.)

EXERCISE 22-e

Shaw, Low and Stevens start in business with a capital of $50,000 of which Shaw contributed $30,000; Low, $10,000; and Stevens, $10,000. Profits are to be divided

equally and, in order to adjust the unequal investments, interest is to be allowed on capital invested at the rate of 6% and, in order to adjust variations in drawings, interest is to be charged on all amounts drawn from the business from the date of withdrawal to the end of the year. Interest is not to appear in the profit and loss statement but is to be adjusted through the partners' current accounts. The average drawings of the partners for the year were as follows:

Shaw	$1,650 for six months and ten days.
Low	1,200 for eight months and fifteen days.
Stevens	900 for two months and six days.

Required:

Entries to adjust interest on capital and drawings.

EXERCISE 22-f

The firm of Austin and Carlton insure the life of Austin for $25,000 payable to the firm. The annual premium is $495 payable in advance. The cash surrender value as printed in the policy is as follows: At end of third year, $1,026; fourth year, $1,420; fifth year, $1,834; sixth year, $2,249. Austin dies during the sixth year and the firm receives a check for $25,000 from the insurance company.

Required:

Prepare journal entries to record all the transactions in connection with the above policy.

QUESTIONS FOR DISCUSSION

1. A invests $10,000 in a business and B invests $8,000. There is no definite agreement as to division of profits. At the end of the year A states that he expected them to be divided in proportion to their investments, while B states that they should be divided equally. Which is correct and why?
2. Name the most common methods of dividing profits in a partnership.
3. May a partner claim a salary for services rendered the firm?
4. What is the purpose of allowing a partner interest on capital invested?
5. May salary and interest on capital be considered as an expense of the business? Explain.
6. Is it necessary to charge interest to Profit and Loss account?
7. For what purpose does a firm sometimes take out insurance on a partner's life?
8. Should premiums on partners' life insurance be charged as an expense of the business?
9. What disposition is made of the amount received from the insurance company in case of death of partner?
10. When partners share capital unequally and profits equally, who loses without an interest charge?

CHAPTER XXIII

SALE AND LIQUIDATION OF A PARTNERSHIP

Partnership Dissolution. — The partnership relation being a personal one there are many causes that may result in dissolution. Some of these causes are as follows:

1. Termination of the partnership agreement.
2. Admission of a new partner.
3. Withdrawal of one of the partners.
4. Mutual agreement of the partners to sell or liquidate their business.
5. Court order on account of misconduct of a partner.
6. Changing the legal organization of the business from a partnership to a corporation.
7. Death, insanity, etc., of a partner.

The articles of agreement may prescribe the procedure to be followed upon dissolution. The usual procedure is to take an inventory, prepare financial statements, close the books, transfer the partners' share of profit and loss to their current accounts, and then close the current accounts into the capital accounts. If the business is continued the retiring partner is paid his capital, or it is paid to his estate in case of death. If sold as a going concern the proceeds are divided among the partners.

Sale of a Partnership Business as a Going Business. — A partnership business is sometimes sold to others and the business continued the same as before except for change of owners. The sale may be made to an individual, to another partnership, or to a corporation. Changing the form of legal organization from a partnership to a corporation amounts to the same thing as selling the business to a corporation. In all of these cases the method of handling the matter on the books of the firm is the same. The books having been closed, the only accounts remaining open in the ledger are those with assets, liabilities, and partners' capital. An account is then opened with the buyer of the business who is known as the Vendee, and entries made in the following order to close the books:

(1) Record on the books the goodwill incidental to the sale of the business by debiting a Goodwill account and crediting the partners' accounts in the proportion in which profits are shared.

(2) Charge the assets (including goodwill) sold to the vendee by debiting the vendee and crediting the various asset accounts.

(3) Credit the vendee for the liabilities assumed by debiting the various liability accounts and crediting the vendee.

(4) Credit the vendee for whatever assets are received from him in payment for the net assets of the partnership by debiting the asset or assets received and crediting the vendee.

(5) Pay off any obligations not assumed by the vendee.

(6) Pay off any partners' loans or salaries.

(7) Distribute the assets received from the vendee by debiting the partners' capital accounts and crediting the asset accounts. Unless otherwise agreed upon, the distribution will be in the ratio that each partner's capital bears to the total capital *at the time of distribution.* In other words, pay each partner enough to balance his capital account and that will take all the assets on hand.

When the foregoing entries have been posted to the ledger, all accounts will balance and the ledger will be closed. The following problem illustrates the procedure.

Illustration

The balance sheet of Hollis and Haven, partners, on January 1, 19— is as follows:

Balance Sheet, January 1, 19—

Assets		Liabilities	
Plant and Machinery	$40,000.00	Notes Payable	$ 5,000.00
Inventory	24,000.00	Accounts Payable	7,000.00
Accounts Receivable	18,350.00	T. A. Hollis, Capital	40,000.00
Cash	4,650.00	J. N. Haven, Capital	35,000.00
	$87,000.00		$87,000.00

The partners decide to sell their business as a going concern to a corporation known as the Hollis Mfg. Co., which has been formed for the purpose of operating the business. The corporation takes over all the assets, except cash, assumes all the liabilities, and turns over to the partners in payment therefor $75,000 of the capital stock of the corporation and $5,000 in cash. The partners share profits equally.

Inasmuch as the firm turns over to the corporation $70,350 net assets and receives in payment therefor assets of a value of $80,000, the difference, or

$9,650, represents a payment for the goodwill of the firm. The journal entries to close the books are as follows:

Goodwill		$9,650.00	
T. A. Hollis, Capital			$4,825.00
J. N. Haven, Capital			4,825.00
To record goodwill resulting from sale of business for	$80,000.00		
Net assets transferred	70,350.00		
Goodwill	$ 9,650.00		
Hollis Mfg. Co., Vendee		92,000.00	
Plant and Machinery			40,000.00
Inventory			24,000.00
Accounts Receivable			18,350.00
Goodwill			9,650.00
To transfer to vendee's account value of all assets transferred.			
Notes Payable		5,000.00	
Accounts Payable		7,000.00	
Hollis Mfg. Co., Vendee			12,000.00
To credit vendee for liabilities assumed.			
Capital Stock of Hollis Mfg. Co.		75,000.00	
Cash		5,000.00	
Hollis Mfg. Co., Vendee			80,000.00
To credit vendee for stock and cash received in payment for net assets of firm.			
T. A. Hollis, Capital		44,825.00	
J. N. Haven, Capital		39,825.00	
Cash			9,650.00
Capital Stock of Hollis Mfg. Co.			75,000.00
To record distribution of assets to partners to balance capital accounts.			

Liquidation of a Partnership. — Instead of a dissolution brought about by the sale of the business as a going concern, in which there is usually a profit for the partners due to the goodwill, a firm sometimes undertakes to dispose of its assets, pay off its liabilities, and close out the business. In this case there is usually a liquidating loss which must be borne by the partners in profit and loss ratio. In such cases the books are closed as before and the trading profit or loss

transferred to the current accounts, which are in turn closed into the partners' capital accounts so that only asset, liability, and capital accounts appear in the ledger. The assets are then converted into cash as soon as possible and the claims against the assets paid in the following order:

1. Mortgages, if any.
2. Preferred outside claims such as wages, taxes, etc.
3. Liabilities due outside creditors.
4. Loans and salaries due partners.
5. Capital accounts of partners.

Any profits or losses resulting from the conversion of the assets into cash are shared by the partners in profit and loss ratio, the same as a trading profit or loss. The bookkeeping procedure for closing the accounts is as follows:

(1) Debit Cash for amount received from the sale of assets, and Profit and Loss for the loss on liquidation; credit the various assets for the value shown on the books.

(2) Debit the partners' capital accounts for the loss on liquidation in profit and loss ratio; credit Profit and Loss account.

(3) Pay off outside liabilities; debit each liability paid off and credit Cash.

(4) Pay off salaries and loans of partners, if any; debit proper accounts and credit Cash.

(5) Distribute the balance of cash among the partners, in capital ratio; this will balance the capital and cash accounts, and close all accounts.

The above procedure will be illustrated by use of the balance sheet of Hollis and Haven on page 196.

Assume that, instead of selling the business to a corporation, the partners decide to convert their assets into cash, pay off their obligations, and go out of business. The plant and machinery are sold for $35,000; the inventory, for $26,000; and the accounts receivable realize $18,000. The bookkeeping entries are as follows:

Cash	$35,000.00	
Profit and Loss	5,000.00	
Plant and Machinery		$40,000.00
To record sale of plant and machinery.		
Cash	26,000.00	
Profit and Loss		2,000.00
Inventory		24,000.00
To record sale of goods on hand.		

Cash	$18,000.00	
Profit and Loss	350.00	
Accounts Receivable		$18,350.00
To record amount realized from conversion of customers' accounts.		
T. A. Hollis, Capital	1,675.00	
J. N. Haven, Capital	1,675.00	
Profit and Loss		3,350.00
To charge partners with loss on liquidation of assets.		
Notes Payable	5,000.00	
Accounts Payable	7,000.00	
Cash		12,000.00
To record payment of liabilities.		
T. A. Hollis, Capital	38,325.00	
J. N. Haven, Capital	33,325.00	
Cash		71,650.00
To record payment to partners to balance capital accounts.		

Partner's Insolvency. — Sometimes the loss from liquidation is so large that one or more of the partners is rendered insolvent thereby. His capital account is entirely wiped out and leaves him in debt to the firm. His capital account in such a case shows a debit balance which he is obliged to make good by paying into the firm cash to that amount.

Illustration

X, Y, and Z, partners, close out their business. After the loss from the sale of assets has been charged to the partners' accounts, and the liabilities paid off, Z's account shows a debit balance of $1,200. X's account shows a credit of $2,500 and Y's a credit of $1,600. The Cash account shows a debit of $2,900.

If Z has property he pays into the firm $1,200 to make good his shortage. His account is then balanced and the cash distributed to the other partners, the entries being as follows:

Cash	$1,200.00	
Z, Capital		$1,200.00
X, Capital	2,500.00	
Y, Capital	1,600.00	
Cash		4,100.00

If Z is unable to make good his deficit, the loss is borne by X and Y in the proportion in which they share profits and losses, and Z's account is closed out. If profits are shared equally, the entries are as follows:

X, Capital	$600.00	
Y, Capital	600.00	
Z, Capital		$1,200.00
X, Capital	1,900.00	
Y, Capital	1,000.00	
Cash		2,900.00

Partnership Accounts in the Financial Statements. — The profit and loss statement has the same form as that for an individual trader, except that the distribution of the net profit is shown at the end, as follows:

Net Profit			$12,270.00
Distributed as follows:			
A. B. Rider: Salary	$2,000.00		
Interest on Capital	1,200.00		
½ Balance of Profit	2,835.00	$6,035.00	
B. A. Merrill: Salary	$2,500.00		
Interest on Capital	900.00		
½ Balance of Profit	2,835.00	6,235.00	12,270.00

The following form of balance sheet is suggested to show each partner's interest:

Capital:			
A. B. Rider's Net Worth:			
Capital Investment		$20,000.00	
Add — One-half net profit for year ending December 31, 19—	$2,835.00		
Interest on Capital	1,200.00		
Total	$4,035.00		
Less — Balance of Current account	840.00	3,195.00	$23,195.00
B. A. Merrill's Net Worth:			
Capital Investment		$15,000.00	
Add — One-half net profit for year ending December 31, 19—	$2,835.00		
Interest on Capital	900.00		
Total	$3,735.00		
Less— Balance of Current Account	465.00	3,270.00	18,270.00

EXERCISE 23-a

The following balance sheet was taken from the books of James and Jones at the close of business, December 31, 19—:

Balance Sheet, December 31, 19—

Assets		Liabilities	
Cash	$ 165,000	Mortgages Payable	$ 200,000
Accounts Receivable	250,000	Accounts Payable	410,000
Merchandise	475,000	Notes Payable	60,000
Real Estate	265,000	T. M. James, Capital	325,000
Equipment	155,000	O. L. Jones, Capital	315,000
	$1,310,000		$1,310,000

James and Jones sell the net assets, except cash, and the goodwill of their business to the Eastern Manufacturing Co. which agrees to assume the liabilities of James and Jones and to pay them $600,000 in cash.

Required:

(*a*) Make entries in general journal form to close out the books of James and Jones.

(*b*) Set up T ledger accounts and post entries in (*a*).

EXERCISE 23-b

A firm of four partners agreed to sell their business to the Hub Mfg. Co. Their assets and liabilities were as follows: C. B. Bliss, Capital, $145,500; M. T. Nichols, Capital, $123,500; S. T. Emery, Capital, $153,000; R. S. Wells, Capital, $152,330; Building, $125,000; Machinery, fixtures, etc., $38,335; Stock, $150,940; Accounts Receivable, $328,680; Notes Receivable, $37,005; Cash, $17,030; Horses and Wagons, $1,230; Unexpired Insurance, $175; Accounts Payable, $124,065.

It was further agreed that the partners were to be paid for goodwill based on a year and a quarter purchase of the last three years' profits, which were respectively $32,620, $37,450, and $50,650. The corporation issues to the partners $600,000 capital stock and pays the balance of purchase price in cash.

Required:

Prepare journal entries to record sale and close the books of the partnership.

EXERCISE 23-c

The following is a trial balance of the General Ledger of a partnership in which the profits were shared equally at the end of the first year of its existence.

Building and Equipment	$ 6,000
Merchandise and Materials	7,000
Accounts Receivable	4,000
Profit and Loss	5,700

EXERCISE 23-c (Cont.)

John Smith, Current	$ 2,500	
George Jones, Current	1,300	
Arthur Morris, Current	2,000	
John Smith, Capital		$10,000
George Jones, Capital		8,500
Arthur Morris, Capital		6,500
Accounts Payable		3,500
	$28,500	$28,500

The firm dissolved the partnership and procured a purchaser, Thomas Evans, who offered $6,000 for the business. The offer was accepted with the understanding that Thomas Evans would assume all existing liabilities, which he agreed to do.

Required:

(*a*) Entry to close Profit and Loss into the partners' current accounts.

(*b*) Entry to close current accounts into capital accounts.

(*c*) Entries to record sale of business and to close all accounts.

NOTE: The business is sold at a loss. Therefore, the difference between cash received and net assets turned over is charged to Profit and Loss instead of Goodwill as in Ex. (23-b). This loss is then charged to the capital accounts in profit and loss ratio, after which the cash is distributed in capital ratio closing all accounts.

EXERCISE 23-d

Thompson and Ward are partners sharing profits equally. The partnership is dissolved December 31, 19—, at which time Thompson's capital is $15,000 and Ward's is $10,000. The total outside liabilities of the firm are $20,000. There is due Ward on a loan $5,000. The total assets, $50,000, are disposed of for $40,000 cash.

Required:

(*a*) Journal entries showing steps in closing out the partnership.

(*b*) Ledger accounts after posting entries in (*a*).

EXERCISE 23-e

T. W. Sharp & Co., who have been conducting an automobile business, finding themselves in financial difficulties, have decided to liquidate their business. On July 1, 19— their ledger contained the following items:

Real Estate	$ 65,000	Mortgage Payable	$ 25,000
Accounts Receivable	9,500	Accounts Payable	12,500
Notes Receivable	5,000	Notes Payable	8,000
Inventory	22,500	T. W. Sharp, Loan	2,500
Store Equipment	2,500	T. W. Sharp, Capital	34,500
Cash	8,000	G. O. Barnes, Capital	30,000
	$112,500		$112,500

The assets were disposed of to the best advantage and realized as follows:

Real Estate	$45,000 cash above the mortgage.
Accounts Receivable	8,000
Notes Receivable	5,000
Inventory	16,000
Store Equipment	1,500

All obligations were paid off and the business closed out.

Required:

Entries in journal form to show steps in liquidation and to close partnership books.

EXERCISE 23-f

C. F. Downey and P. E. Sanders, competitors in the automobile business, decide to form a partnership, all the assets and liabilities of each to be taken over by the new firm at book valuation. The balance sheets of the respective partners at the time of consolidation are as follows:

C. F. Downey

Balance sheet, April 1, 19—

Assets		Liabilities	
Cash	$ 2,500	Accounts Payable	$ 9,000
Accounts Receivable	7,000	Notes Payable	6,000
Merchandise	18,000	C. F. Downey, Capital	35,000
Equipment	4,500		
Real Estate	18,000		
	$50,000		$50,000

P. E. Sanders

Balance sheet, April 1, 19—

Assets		Liabilities	
Cash	$ 2,000	Accounts Payable	$ 8,000
Accounts Receivable	3,500	Notes Payable	5,000
Merchandise	15,000	P. E. Sanders, Capital	25,000
Equipment	2,500		
Real Estate	15,000		
	$38,000		$38,000

Required:

(*a*) Entries to open the books of the partnership.

(*b*) A. L. Bishop buys a one-third interest at book value for cash. It is agreed that the capital accounts are to be adjusted so that they shall all be equal. Make

entries to properly adjust accounts and show admission of Bishop. State what amount of cash each partner will receive.

(*c*) A. B. Cramer buys from Downey one-half of his interest in the business and with the consent of the other partners is admitted to the firm. Make entry to adjust the accounts and show admission of Cramer.

(*d*) Assuming that the partners share profits and losses in proportion to capital investments, and that the profits at the end of the year amount to $24,000, submit entries to show division of profits among the four partners, profits being carried to the partners' capital accounts.

The profits have increased the assets in the following amounts:

Merchandise, $12,000; Accounts Receivable, $8,000; Cash, $4,000.

Make entry to record these increases crediting Profit and Loss account.

(*e*) The partners decide to form a corporation to be known as the Downey-Sanders Auto Sales Co. for the purpose of operating the business. The corporation takes over all the assets including cash, assumes all the liabilities of the partnership, and issues to the partners $100,000 in stock of the corporation. Prepare entries to close the partnership books.

QUESTIONS FOR DISCUSSION

1. Is the partnership relation a permanent one?
2. Name some causes that may result in the dissolution of a partnership.
3. In case of dissolution what are the first bookkeeping steps to be taken?
4. What is meant by selling a partnership business as a "going concern"?
5. What is meant by the term "vendee" and how is it used in the books?
6. When a firm decides to dispose of its assets individually and pay off its obligations, in what order must the latter be taken care of?
7. What is the usual difference between selling the business as a "going concern," and disposing of the assets and paying off the obligations and closing out the business, as far as the partners' capital accounts are concerned?
8. Explain how the matter is handled on the books when a partner's capital account shows a debit balance at the time of dissolution and he is insolvent.
9. On what basis are the net assets divided in winding up the affairs of a partnership?
10. In case assets do not realize the value shown on the books when disposed of, what is done with the difference?
11. How should the balances of the partners' drawing accounts appear in the balance sheet?
12. O'Neil and Brown form a partnership for the purpose of conducting a retail store business, both investing $20,000. It is agreed that profits and losses are to be shared: O'Neil, $\frac{2}{3}$; and Brown, $\frac{1}{3}$; and that each partner is to be allowed interest on his investment at the rate of 6% per annum.

(*a*) Why is an interest clause sometimes included in the articles of copartnership?

(*b*) What would be the effect, if any, of the interest clause above if profits and losses were shared equally?

(*c*) If their capital investments were in the ratio of O'Neil $\frac{2}{3}$ and Brown $\frac{1}{3}$ and profits and losses were shared equally, which partner would lose without the interest clause?

(*d*) In the above proposition what effect does the interest clause have upon the net return to each partner?

(*e*) Give a situation where neither partner would lose without the interest clause?

(*f*) Does the inclusion of the interest clause affect the net profit of the business?

(*g*) Can such interest be handled without putting it through the Profit and Loss account? Explain.

(*h*) Is a partner ever charged interest on drawings? If so, why?

(*i*) What basis is used in figuring interest on investments and drawings?

(*j*) Is the interest in (*i*) an expense or an income of the business?

(*k*) Should the partners sell out their business as a going business for $55,000 in capital stock, what would the excess of $15,000 over their net assets represent and how would this amount be divided between the partners? On what basis would the $55,000 in capital stock be distributed?

SUMMARY OF CHAPTERS XX–XXIII

Business enterprises are classified with respect to their legal organization as individual proprietorships, partnerships, and corporations. The working organization may be the same under all three types. The capital of a partnership is divided among two or more persons who have combined their resources for the purpose of conducting a business for their mutual profit. The special features of a partnership are mutual agency, limited life, full debt liability, and lack of legal unity.

The written contract to form a partnership is known as Articles of Copartnership. When there is no written contract the law provides that profits shall be shared equally and that partners cannot claim salaries or interest on capital.

Accounting features peculiar to partnerships have to do with recording partners' investments and drawings, division of profits and losses, and liquidation or sale of the business. The routine transactions do not vary from those of other types of business. A separate account is kept with the partner's investment and another for drawings and current transactions. Loan and Salary accounts may also be kept.

Complete particulars concerning the formation of a partnership appear in the General Journal. A new partner may be admitted to a firm with the consent of the other partners. The new partner's investment may go into the busi-

ness, in which case the net worth is increased by the amount of his investment; or his investment may go to the old partners personally, in which case the net worth is not increased. An interest may be secured *at book value*, *above book value*, or *below book value*. When secured at above book value the element of "goodwill" is present. Goodwill brought on the books as an asset is credited to the old partners in profit and loss ratio. The valuation of goodwill is a matter of agreement among the partners. When an interest is secured at less than book value the partners share the loss in profit and loss ratio.

The basis for dividing profits and losses is usually agreed upon by the partners, and frequently bears some relation to their investments. Salary and interest allowances are special distributions of profits before the general distribution. They have the effect of adjusting unequal investments, drawings, etc.

Insurance on a partner's life is carried on the books as an asset for the amount of the cash surrender value of the policy. The remainder of the insurance premium is an expense. Upon the death of the partner his estate shares in the proceeds of the insurance policy.

A partnership is terminated by the admission or withdrawal of a partner. It may be sold as a "going" business, an amount usually being paid for goodwill which is divided among the partners. When the same books are used, the accounts are adjusted and the old capital accounts closed out and new ones opened. A firm may sell its assets, pay off its obligations and go out of business. In such cases there is usually a loss on account of liquidation. This loss is divided among the partners in profit and loss ratio, after which the remaining assets are distributed to the partners in capital ratio. In liquidating, if a partner becomes insolvent he is obliged to pay into the firm enough to make good his deficit; if unable to do this, his deficit is charged to the other partners in the ratio in which they share profits and losses as between themselves.

Salaries and interest should be shown as a distribution of profits in the profit and loss statement. The balances of the partners' Current accounts are added to or deducted from their Capital accounts in the balance sheet.

BUSINESS PRACTICE SET NO. 3

This is a Wholesale Dry Goods set with incoming vouchers, blank forms, and record books; it may be worked at the close of Chapter XXIII, at the option of the teacher.

This set serves as a review of principles covered thus far in the text and also as practice in the technique of keeping a complete set of books.

CORPORATIONS

CHAPTER XXIV

THE CORPORATE ORGANIZATION

Corporation Defined. — A corporation may be defined as "a group of persons associated by law for a specific purpose under a common name with legal authority to act as one individual." While it is composed of a number of individuals it differs from a partnership in many respects. It may carry on business in its own name and has a common seal which must be affixed to important contracts. It acts in all ways the same as an individual in transacting business and may sue and be sued in its own name.

Corporations Compared with Partnerships. —

(1) *Method of Formation.* — A corporation is formed by securing a charter or privilege of doing business in accordance with the laws of the State; a partnership needs no special authority, but is formed by verbal or written contract known as the articles of copartnership.

(2) *Scope of Business.* — The authority from the State defines the scope of the corporate business; the partnership is not so restricted.

(3) *Management.* — The management of the corporation is delegated to properly elected officials; in a partnership, a partner acting for the firm may legally bind the firm by contract.

(4) *Liability of the Members.* — In a corporation, the liability of each member for the debts of the corporation is limited to the amount of his investment, except where there is a special provision in the State law to the contrary; in a partnership each member is individually liable for the debts of the firm to the extent of his personal estate if necessary.

(5) *Manner of Dissolution.* — A corporation is not dissolved by changes among its members on account of death, sale of interest, etc.; any of these causes dissolves a partnership.

Ownership in a Corporation. — In an individual proprietorship the ownership of the business is vested in the proprietor and is shown on the books in his Capital and Personal accounts. In the partnership the ownership is vested in the individual partners as indicated by the partners' Capital and Current accounts. There are as many Capital and Current accounts as there are partners.

In the corporation, however, the ownership is vested in the corporation itself, which is an artificial person created for the purpose of owning and operating the business. There is but one Capital account in the books and the names of the members do not appear in the General Ledger. The capital of the corporation is divided into equal par value units known as shares. The usual par value unit is $100 but a share may have any par value less than $100, in some states the minimum being $5. The members of the corporation own one or more of these shares and are known as shareholders or stockholders. The shareholders own shares of stock in the corporation which in turn owns the assets.

Capital Compared with Capital Stock. — The *capital* of a corporation is found in the same manner as under the other forms of ownership; namely, by deducting the liabilities from the assets. It, therefore, represents the *net worth* of the business and is constantly changing, depending upon whether the business is making or losing money. *Capital stock* on the other hand is fixed and refers to the ownership interest in a corporation.

The amount of capital stock is determined at the time the corporation is formed. If $50,000 is needed to develop a business, permission may be secured from the state to sell 500 shares of $100 each. When an investor pays $100 in cash or property, the secretary gives him a receipt for his money known as a *stock certificate*. This is evidence that he has a share in the ownership to the extent of $100. The capital stock of the corporation then is the sum of the certificates issued in exchange for cash or property. At the time the corporation is formed, if the value shown on the stock certificates is paid in full, the capital and capital stock are the same in amount. If the capital stock of the company is $50,000 divided into 500 shares of $100 and $50,000 cash is received for the same, the capital or net worth is also $50,000.

Procedure for Organizing a Corporation. — The exact procedure for the formation of a corporation is determined by the laws of the state in which the corporation is formed. Each state has a Corporation Law which sets forth the steps that must be taken to form a corporation. The general requirements are the same in all states but differ as to details.

In most cases an application for permission to organize a corporation must be prepared and signed by at least three persons who are designated as the incorporators. This application is addressed to the proper state official and contains among other things the following: the name of the corporation; the location of its office and place of business; the purpose for which created; the amount of capital stock to be issued; the number of shares into which the capital stock is to be divided; etc.

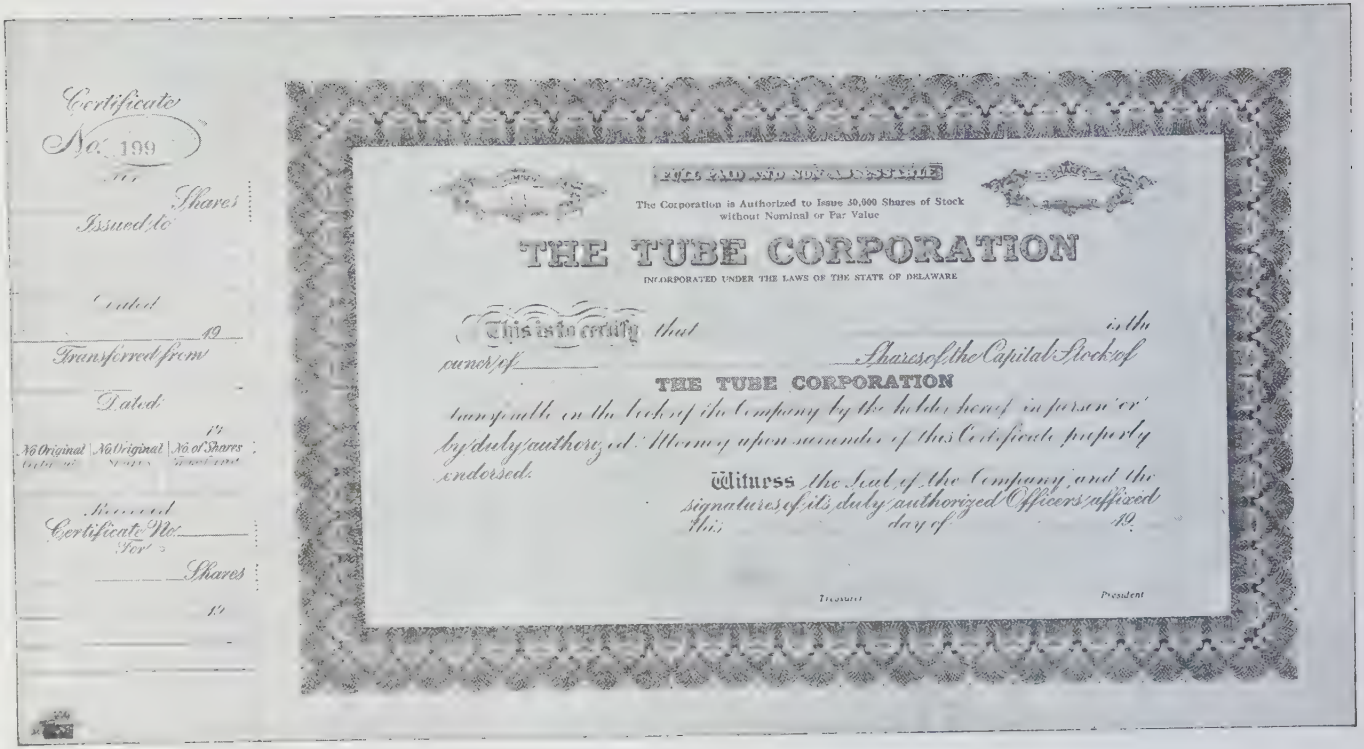

Certificate
No. 199
Shares
Issued to
Dated
19
Transferred from
Dated
19
No. Original Certificate
No. Original Shares
No. of Shares Transferred
Received
Certificate No.
For
Shares
19
FULLY PAID AND NON-ASSESSABLE
The Corporation is Authorized to Issue 50,000 Shares of Stock without Nominal or Par Value
THE TUBE CORPORATION
INCORPORATED UNDER THE LAWS OF THE STATE OF DELAWARE
This is to certify that
is the owner of
Shares of the Capital Stock of
THE TUBE CORPORATION
transferable on the books of the Company by the holder hereof in person or by duly authorized Attorney upon surrender of this Certificate properly endorsed.
Witness the Seal of the Company and the signatures of its duly authorized Officers affixed this
day of
19
Treasurer
President

Illustration — A Stock Certificate

CERTIFICATE OF INCORPORATION
OF
BLACK RIVER STONE CO., INC.

We, the undersigned, all being persons of full age, and at least two-thirds being citizens of the United States and at least one of us a resident of the State of New York, desiring to form a stock business corporation pursuant to the provisions of the Business Corporation Law, The General Corporation Law and The Stock Corporation Law of the State of New York, do hereby make, sign, acknowledge, and file a certificate for that purpose, as follows:

First: The name of the proposed corporation is

BLACK RIVER STONE COMPANY, INC.

Second: The purposes for which it is formed, are:

A. To engage in the business of mining, quarrying and crushing stone; to engage in the manufacture of cement blocks, and concrete posts; to engage in the business of buying, manufacturing and selling building stone, crushed stone, cement blocks, cement posts and all other kinds of stone, concrete materials and concrete blocks; and to engage in the business of building and repairing roads.

B. To conduct its business in all its branches, to have one or more business offices and without restrictions to contract for, buy, sell, hold, lease, mortgage, grant and otherwise acquire, and dispose of all real and personal property as shall from time to time be found necessary and convenient for the purpose of the corporation's business.

Third: The amount of the capital stock is ten thousand dollars ($10,000) common.

Fourth: The number of shares of which the capital stock shall consist is one hundred, of the par value of one hundred dollars each, and the amount of the capital with which said corporation will begin business is three thousand dollars.

Fifth: Its principal office is to be located in the city of Black River, Jefferson County, N. Y.

Sixth: Its duration is to be perpetual.

Seventh: The number of its directors is to be three.

Eighth: The names and post office addresses of the directors for the first year are as follows:

Stewart Walton,	125 So. Main Street, Albany, N. Y.
George W. Allison,	25 Broad Street, Black River, N. Y.
B. W. Hollis,	10 Broadway, New York, N. Y.

Ninth: The names and post office addresses of the subscribers to the certificate and a statement of the number of shares of stock which each agrees to take in the corporation are as follows:

Stewart Walton,	125 So. Main St., Albany, N. Y.	50 shares
George W. Allison,	25 Broad St., Black River, N. Y.	25 "
B. W. Hollis,	10 Broadway, New York, N. Y.	25 "

In Witness Whereof, we have made, signed, acknowledged and filed this certificate in duplicate.

Dated January 1, 19—

Stewart Walton
George W. Allison
B. W. Hollis

State of New York }
County of Jefferson } ss.

On January 1, 19— before me, the subscriber, personally appeared Stewart Walton, George W. Allison, and B. W. Hollis to me known and known to me to be the same persons described in and who executed the above instrument and they duly acknowledged to me that they executed the same.

George F. Williams

(Notarial Seal)

Notary Public, Jefferson County, N. Y.

The Charter or Certificate of Incorporation. — After the Articles of Incorporation have been properly filled out and submitted to the proper state official, usually the Secretary of State, they are endorsed by him and returned to those forming the corporation who are known as the incorporators. In some states a separate document is prepared by the Secretary of State. In either case this is known as the charter of the corporation and is really a contract between the state and the incorporators. It is the authority under which the corporation carries on its business. The existence of the corporation starts from the date of the charter. A form of Certificate of Incorporation is shown on page 210.

By-Laws. — By-laws refer to the rules and regulations adopted by the corporation for the conduct of its business affairs. The charter contains the general powers conferred by the state, while the details of management are set forth in the by-laws which are prepared at the first meeting of the stockholders. They provide for the manner in which stock is to be issued and transferred; time and place of stockholders' meetings; number and power of directors and when elected; the appointment of officers and their duties, rights and compensation; how funds are to be handled, etc.

Board of Directors. — Directors are elected by and from the stockholders and are responsible for the management of the business of the corporation. Their number, not less than three, and their powers are fixed by the by-laws. They appoint the officers and pass upon all details of the business not delegated to the officers by the by-laws. In electing the directors a stockholder has, as a rule, one vote for each share of stock owned by him. However, at a directors' meeting each director has but one vote irrespective of the number of shares owned by him.

Officers. — The number of officers, their titles, and their duties vary with the size of the corporation. They carry on the business of the corporation in accordance with the charter and by-laws and the authority delegated to them by the Board of Directors. The usual officers are the President, who is the chief executive officer; the Vice-President, who assists the President and assumes his duties in his absence; the Secretary, who keeps the corporate seal and the minute book containing a record of the proceedings of the various directors' and stockholders' meetings; and the Treasurer, who is in charge of the financial affairs of the corporation. In some instances the last two offices are held by the same person. A Chairman of the Board of Directors is sometimes elected who ranks above the President and whose duties are set forth in the by-laws.

Stockholders. — Stockholders are those who own one or more shares of stock in a corporation. They are the owners of the business just as the partners are

the owners of a firm, but differ in that they take no active part in its management unless they have been made directors or officers. Their ownership is evidenced by a written document known as a stock certificate illustrated on page 209. These certificates may have been purchased from the corporation or from another stockholder and must be recorded in the name of the stockholder on the books of the corporation in order to constitute legal title. The stockholders elect the Board of Directors and adopt by-laws for the conduct of the business. They hold a meeting at least once a year for the election of directors and to conduct such other business as may properly come before them.

Classes of Capital Stock. — The capital stock of a corporation may be all of one kind or it may be divided into two or more classes. When there are two classes of stock, one has certain preferences over the other and is known as *preferred stock;* the other class over which the preferred stock has preference is known as *common stock*. The most common privilege accorded preferred stockholders is the right to receive a stated rate of income out of the profits of the company before anything is paid to the common stockholders. Thus, 6% Preferred Stock means that 6% income on the par value of the stock certificates will be paid the preferred stockholders before the common stockholders receive any income.

If a company has a capital stock of $100,000 of which $50,000 is 6% preferred and $50,000 common stock and profits to be distributed to stockholders amount to $3,000, the preferred stockholders will take it all and the common stockholders will receive nothing for that year.

The preferred dividends, or stated share of the profits, are sometimes made *cumulative*, which means that if the profits in any year are not sufficient to pay the stated amount, the amount remaining unpaid must be paid in the following years before the common stockholders are permitted to receive any dividends. Thus, if profits for distribution amount to only $2,000 this amount is paid to preferred stockholders and the balance of the stated dividend of $3,000, or $1,000, holds over until the next year and must be paid before the common stockholders get anything. If *non-cumulative*, at the expiration of the year the $1,000 will be lost to the preferred stockholders.

Or, if the dividends to be distributed amount to $8,000, $3,000 is distributed to the preferred stockholders and the balance, $5,000, goes to common stockholders. In such cases the preferred stock is said to be *non-participating*. If the preferred stock is *participating*, the preferred stockholders will receive $3,000 and both classes of stock will share equally in the remaining $5,000.

The charter and the stock certificates usually indicate the rights and privileges of the various classes of stock.

Preferred stock usually takes precedence over common stock in payment of assets. If the corporation is dissolved the preferred stockholders receive their share of investment before any distribution is made to the common stockholders.

Treasury and Unissued Stock. — Capital stock that has once been issued and later acquired through purchase or gift by the corporation is called *treasury stock*. The corporation thus becomes one of its own stockholders. Treasury stock, however, has no standing as far as voting or receiving dividends is concerned. It must not be confused with *unissued stock* which is stock that the company has authority to issue under its charter but which has never been sold and issued.

Par and No Par Value Stock. — The nominal value placed upon shares by the incorporators at the time the corporation is being formed is their *par value*. It is the value of the stock that is stated on the certificate. A large number of states have authorized the issue of shares without any stated or par value. Such stock is known as *no par value stock*. There is very often a minimum value at which this stock can be sold; in some cases this is placed at $5 per share. Reference is sometimes made to the *book value* of stock. The *book value* is found by dividing the net worth of the corporation by the number of shares outstanding. The book value in a given case is the same whether the company issues par value stock or no par value stock. The *market value* of stock refers to the value that the stock will bring per share when sold on the stock market. This value is often determined by the income the stock produces. Stocks having low book value, but paying large dividends, sometimes have a higher market value than other stocks having high book value but paying low dividends.

The same share of stock may have a par value of $100, a book value of $105, and a market value of $90. A corporation is authorized to issue $100,000 of stock divided into 1,000 shares of $100 each. The par value of the stock is then $100 per share. Or, the authorization may be for $100,000 divided into 1,000 shares of no par value. After being in business for a year the corporation makes a profit of $5,000 so that the net worth is $105,000. This amount divided by 1,000 shares gives $105, the book value of the stock. The company finds it necessary to use the profits in the business and, therefore, pays no dividends, and the outlook for this type of business is poor so that the shares sell for $90 on the market.

Dividends — Profit Sharing in a Corporation. — The proportion of profits of a corporation distributed among the stockholders is called the *dividend*. In an individual proprietorship the profits of a business are credited to the capital or

current account of the owner; in a partnership they are usually credited to the partners' current accounts in the agreed ratio; in a corporation they are credited to an account called *Surplus*. When the earnings are withdrawn in the form of dividends they are charged to Surplus account just as drawings in the other forms of organization were charged to the current accounts. The balance of Surplus account represents earnings not distributed to stockholders.

Dividends are usually expressed as a per cent of the par value of stock or, in the case of no par value stock, a given number of dollars per share. Thus, a 5% dividend for a $100,000 corporation would mean that they were distributing $5,000 among the stockholders. If A owned five shares of stock he would receive 5% of $500, or $25, as his share of the dividend. Dividends may not be paid legally unless they have been earned by the business. They are controlled by the directors, and a stockholder cannot claim a dividend even though earned, unless the directors decide to authorize the same.

Advantages of the Corporate Organization. — Some of the advantages of the corporate organization are as follows:

(1) *Permanency.* — Death, retirement or other changes in its membership in no way affect the legal existence of the corporation. It exists for the period stated in its charter unless the members vote to dissolve. This is known as the *right of succession*. Therefore, for large undertakings and those extending over a long period of time the corporate form of business is to be preferred.

(2) *Limited Liability of Members.* — As a general rule a member's liability is limited to the amount of his investment as indicated by the par value of the stock that he holds. His private property is not involved in any way and it is no reflection upon his personal credit if the corporation should get into financial difficulty and fail.

(3) *Transferable Ownership.* — By means of the corporate stock system of dividing the capital into transferable shares which become personal property the members may transfer their shares at any time and without in any way affecting the legal existence of the corporation.

(4) *Large Capital Possible.* — The units of ownership are small enough to attract a large number of persons who are willing to invest a small amount and also enable large investors to scatter their investments.

(5) *Centralized Management.* — The management is delegated to the officials of the company whose duties and authority are clearly defined. The stockholders have no authority to act for the corporation.

Disadvantages of the Corporate Organization. — Some of the disadvantages claimed for the corporate organization are as follows:

(1) *Governmental Supervision.* — Inasmuch as a corporation receives its authority to do business from the state it is subject to state supervision which makes it necessary to file numerous reports, have its records open for inspection of officials, and be subject to a heavy burden of taxation in every state in which it does business.

(2) *Scope of Business Restricted.* — The corporation is not permitted to engage in any other business than that stated in its charter without securing permission from the state.

(3) *Limitation of Credit.* — While the limited liability is an advantage to the members of the corporation it is a disadvantage to the creditors and they, therefore, sometimes are unwilling to grant an extended line of credit such as they would to a partnership, the members of which are liable to the extent of their personal estate.

QUESTIONS FOR DISCUSSION

1. In what respects does a firm consisting of three members differ from a corporation consisting of three stockholders?
2. Why have corporations become the most popular type of business organization?
3. Outline five common differences between partnerships and corporations.
4. Name some advantages of the corporate form.
5. A corporation is said to be an artificial person. In what respect is it like an individual?
6. Is there any difference between the capital and the capital stock of a corporation?
7. What evidence does a shareholder in a corporation have to show that he owns stock?
8. If a stockholder loses his stock certificate, how is his interest in the corporation protected?
9. Outline the procedure for organizing a corporation in your own state.
10. What is meant by the Charter or Certificate of Incorporation?
11. What officials of the state usually administer the corporation law?
12. What are meant by by-laws; by whom and when are they adopted?
13. Name some of the usual provisions contained in the by-laws.
14. What are the duties of the directors of a corporation and when and by whom are they chosen?
15. Name the usual officers of a corporation. What is the source of their authority?
16. Explain the difference between common and preferred stock.

17. What are dividends on capital stock? Explain how they are computed for both par and no par value stock.

18. What is the difference between par and no par value stock?

19. Explain what is meant by 5% cumulative preferred capital stock.

20. Explain the difference between participating and non-participating preferred stock.

21. Is there any difference between treasury stock and unissued stock? Explain.

22. What is meant by the "limited liability" of a stockholder as distinguished from the liability of a partner in a firm?

23. Is it possible for common stock to be worth more than preferred stock? Explain.

24. How is it possible for a share of stock to have par, book and market values all of a different amount? Illustrate.

25. What rights does a stockholder have in the management of the business of the corporation?

26. What is meant by "surplus" as applied to corporations?

27. Name the usual information required in the application for a charter.

28. What is meant by the " right of succession " as applied to corporations?

29. Explain wherein the following classes of stock differ one from the other: (*a*) common stock, (*b*) 6% preferred stock, (*c*) 6% cumulative preferred stock.

30. Name some of the advantages and disadvantages claimed for the corporate type of business organization.

31. How does the term " surplus " differ from that of " net worth "?

32. Why is a surplus or deficit account necessary in corporation bookkeeping?

CHAPTER XXV

CAPITAL STOCK ACCOUNTS

The Purpose of Special Accounts. — The majority of business transactions are the same whether the ownership of a business is that of individual proprietorship, partnership or corporation. Therefore, for the routine transactions the same kind of accounts are used, the number and name depending upon the size and nature of the business. The difference comes in recording the capital or ownership, and in the distribution of profits. Instead of recording the ownership interest under the proprietor's name or in the name of the partners it is recorded in an account called Capital Stock. The profits are transferred from the Profit and Loss account to an account called Surplus, and the part of the surplus to be distributed to the stockholders is recorded in an account called Dividends Payable. Inasmuch as capital stock is issued under many varying conditions a number of accounts in addition to the Capital Stock account are sometimes necessary to record the transactions concerning the issue and payment of stock. An account is kept with each stockholder in a Stockholders Ledger described on page 251, which is a subsidiary ledger for which Capital Stock account in the General Ledger is the controlling account.

Capital Stock Account. — This account shows the total *par value* of the capital stock issued and outstanding. It represents the total of all stock certificates issued and not canceled.* The account is credited for the par value at the time the stock certificates are issued, cash or other assets received in payment being debited. The account is debited when the capital stock of the corporation is reduced in any way and the stock certificates canceled. The balance of the account represents the total *par value* of stockholders' holdings as shown by the Stockholders Ledger and appears in the balance sheet under the *capital* section in place of the owners' or partners' capital accounts. When a corporation issues both common and preferred stock it is necessary to keep a capital stock account with each. They are recorded under separate titles as Capital Stock-Common and Capital Stock-Preferred.

Opening Entries. — It is customary to write the particulars concerning the organization of the corporation in the General Journal. The opening statement in

* Form of stock certificate illustrated on page 209 and described on page 250.

the journal includes the date when the corporation was formed, the amount of authorized capital stock, the number and par value of shares, the purpose of the organization and any other information that will be of interest to the bookkeeper for his guidance in keeping the records.

Illustration

C. E. Banes, Geo. Elliot, and Victor Bennett form a corporation to be known as the Radio Mfg. Company with an authorized capital stock of $100,000, divided into shares of $100 each. On January 1, 19— the charter is received, at which time the stock is all subscribed, paid for in cash, and the stock certificates issued. Banes and Elliot each take 400 shares and Bennett takes the other 200 shares. The opening entry is shown as follows:

GENERAL JOURNAL

January 1, 19--

	The Radio Mfg. Company has been incorporated this date under the Business Corporation Law of the State of Massachusetts with an authorized capital stock of one hundred thousand dollars ($100,000) divided into 1,000 shares of a par value of $100 per share. The corporation is authorized to manufacture and deal in radio equipment. Its main office is located at 80 State Street, Boston, Massachusetts. The capital stock is all taken by the incorporators, C.E.Banes, Geo. Elliot, and Victor Bennett; paid for by them in cash, and stock certificates issued to them. See C.R.J. page 219.				
✓	Cash			100000	00
	Capital Stock				100000 00
	To record issue of stock certificates as follows:				
		Cert.	Shares	Amount	
	C.E.Banes	#1	400	$40,000	
	Geo.Elliot	#2	400	40,000	
	Victor Bennett	#3	200	20,000	
			1,000	$100,000	

CASH RECEIPTS JOURNAL

Date	Fol.	Account Cr.	Particulars	Sundry Credits	Accts. Rec.	Sales Disc.	Net Cash Receipts
19--							
Jan. 1	✓	Cap. Stock	Banes' sub.	40000 00			40000 00
1	✓	Cap. Stock	Elliot's sub.	40000 00			40000 00
1	✓	Cap. Stock	Bennett's sub.	20000 00			20000 00

The foregoing entries represent the simplest form of organization. The entry for the cash may be omitted from the journal if desired; and, in that procedure, the entry for capital stock is posted from the Cash Receipts Journal.

In addition to the entries in the General Journal and Cash Receipts Journal, as each incorporator pays cash, a stock certificate is issued to him and the stub of the Stock Certificate Book properly filled out and posted to the Stockholders Ledger. This gives each stockholder credit for the number of shares that he owns. The Stockholders Ledger may be the ordinary ledger form or a specially ruled form such as shown on page 251.

If the capital stock of the Radio Mfg. Company had been divided into two classes, $50,000 Common and $50,000 Preferred, the entries would be the same as the foregoing, except that the particulars would describe the stock differently and there would be two capital stock accounts instead of one. The journal entry would be as follows:

✓ Cash	$100,000.00	
Capital Stock-Common		$50,000.00
Capital Stock-Preferred		50,000.00

Under the laws of most states capital stock may be issued for cash, tangible or intangible property, services or expenses. If in the case of the Radio Mfg. Company C. E. Banes transferred to the corporation real estate valued at $25,000 and equipment worth $5,000 in part payment for his stock, the particulars would be changed to include this detail and the journal entry would be as follows:

✓ Cash	$70,000.00	
Building and Lot	25,000.00	
Equipment	5,000.00	
Capital Stock		$100,000.00

The entry in the Cash Receipts Journal is the same as before except that

Banes' entry is for $10,000 instead of $40,000. Cash in the General Journal and Capital Stock in the Cash Receipts Journal should be checked.

Unissued and Authorized Capital Stock Accounts. — The total amount of capital stock that a corporation may issue as stated in its charter is known as the *authorized* capital stock. The law in some states defines the minimum amount of stock that must be issued. It is seldom required that the entire authorized amount be issued when the charter is granted. It is expected that more capital will be required as the business expands and only enough is issued at the beginning to secure capital required at that time. The amount of stock issued is known as the *outstanding* stock. The difference between the *authorized* and the *outstanding* stock is the *unissued* stock.

When only part of the stock is issued the entry may be made as in the foregoing illustration; in that case no record is made in the ledger of the total amount authorized or the amount unissued. To show the authorized and unissued stock two ledger accounts are used — *Capital Stock Unissued* and *Capital Stock Authorized.* Assuming in the case of the Radio Mfg. Company that only 50% of the capital stock is issued at the time of formation, the entry is made in the General Journal as follows:

Capital Stock Unissued	$100,000.00	
Capital Stock Authorized		$100,000.00

This entry is made at the time the charter is received from the State. It does not represent a regular business transaction and is, therefore, known as a *memorandum* entry. The entry in the Cash Receipts Journal to record the payment for and issue of the stock is as follows:

Cash	$50,000.00	
Capital Stock Unissued		$50,000.00

As the remainder of the stock is sold and certificates issued entries similar to the foregoing are made.

No other entry is made affecting the Capital Stock Authorized account until all the unissued stock is disposed of, when the following entry is made:

Capital Stock Authorized	$100,000.00	
Capital Stock		$100,000.00
To close out authorized stock account and record in the account representing outstanding stock.		

At any time before the capital stock is all issued, the amount of outstanding stock is found by deducting the balance of Capital Stock Unissued account

from that of Capital Stock Authorized account. The trial balance of the Radio Mfg. Company after the 50% of stock has been issued, when recorded as above, appears as follows:

Cash	$ 50,000.00	
Capital Stock Unissued	50,000.00	
Capital Stock Authorized		$100,000.00
	$100,000.00	$100,000.00

The capital stock accounts should appear in the capital section of the balance sheet in the following manner:

Capital:			
Capital Stock Authorized	1,000 shares	$100,000.00	
Less — Unissued Stock	500 shares	50,000.00	
Issued and Outstanding	500 shares		$50,000.00

Sale of No Par Value Stock. — No par value stock is recorded at the value received for it whether that be in cash or property. When property is received in payment for stock the value of the stock is determined by the value placed upon the property received. If 100 shares of no par value stock are sold for cash at $90 per share the entry is as follows:

Cash	$9,000.00	
Capital Stock (100 shares)		$9,000.00

If 500 shares are issued in payment for a building valued at $40,000 the value of each share of stock is $80 and the entry is as follows:

Buildings	$40,000.00	
Capital Stock (500 shares)		$40,000.00

No par value stock appears in the balance sheet in the same manner as par value stock.

Organization Expenses. — In organizing a corporation, certain necessary expenses are incurred such as attorney's fees, commissions for selling stock, publicity, incorporation fees, corporation books and records, etc. Inasmuch as these are not ordinary expenses due to the conduct of the business but are considered as benefiting the corporation in future periods, they may be considered as an asset and gradually written off as expense over a period of years. This class of expense is *deferred* until the company is in a better financial position to bear this expense. The number of fiscal periods over which this asset will be written off is left to the discretion of the Board of Directors. At

the time these expenses are incurred, Organization Expenses account is debited and Cash or Accounts Payable account is credited. In Massachusetts the incorporation fee is "$\frac{1}{20}$ of one per cent of authorized capital with par value, and five cents a share for all authorized shares without par value but not less than $50." In the case of the Radio Mfg. Company the entry for payment of this fee is as follows:

Organization Expenses	$50.00	
Cash		$50.00

This entry is made in the Cash Payments Journal in the usual manner.

EXERCISE 25-a

Abbott, Birch and Collier associate themselves together to organize a corporation with an authorized capital stock of $75,000, par value of shares $100, for the purpose of carrying on an automobile sales agency. On July 1, 19—, their application having been approved by the Commissioner of Corporations, a charter is issued to them. On this date the stock is all taken by the incorporators in equal amounts, paid for by them in cash, and stock certificates issued.

Required:

(*a*) Opening entries on the books of the corporation.

(*b*) Entry for payment of $\frac{1}{20}\%$ corporation fee (not less than $50).

EXERCISE 25-b

A corporation is organized with an authorized capital stock of $200,000 divided into 1,000 shares of common and 1,000 shares preferred, par value $100 each, for the purpose of developing a patent owned by X. $50,000 of the common stock is issued to X for his patent and the remainder to Y for a factory building, stock certificates being issued to them. The preferred stock is all sold for cash and the stock certificates issued therefor.

Required:

Prepare opening entries.

EXERCISE 25-c

The Jones-Sweet Co. is incorporated on July 1, 19— with an authorized capital stock of $100,000. $75,000 of the capital stock is sold at par, payment received in cash, and stock certificates issued. The remainder of the stock is not to be issued at present.

Required:

(*a*) Entries in journal form to record the original stock issue.

(*b*) Assume that the balance of the stock was sold, paid for and issued on December 1, 19—. Show the additional entries required to record the transaction.

EXERCISE 25-d

Allen Dwight, Inc., retail shoe dealers, incorporated on March 1, 19—, has an authorized capital of $25,000 divided into 500 shares of $50 each. At the time of incorporation 200 shares were issued in exchange for cash. It was decided not to issue the balance of the stock at that time.

Required:

(*a*) Make opening entries showing two methods of recording the original issue of stock.

(*b*) Show the entries under both of the above methods assuming that the balance of the stock was sold, paid for in full and issued on September 1, 19—.

EXERCISE 25-e

A corporation is formed with an authorized capital of $50,000, par value $50, divided into 500 shares common and 500 shares 6% cumulative preferred participating stock. Of the common stock 50 shares are issued in payment of organization expenses, 100 shares are issued in exchange for real estate, and 150 shares are issued for cash. All of the preferred stock is sold for cash, paid for in full and issued. The incorporation fee of $\frac{1}{20}\%$ is paid in cash.

Required:

(*a*) Entries in journal form to show issue of stock and payment of incorporation fee.

(*b*) Show the capital stock accounts as they would appear in the balance sheet.

EXERCISE 25-f

Robert Morrison decides to go into business with R. E. Brooks and Robert Vahey, contractors. A corporation is formed under the name of The Robert Realty Co. with an authorized issue of 500 shares of no par value stock, for the purpose of carrying on a real estate business. Brooks and Vahey each take 150 shares, Brooks giving in payment $10,000 in land and $5,000 in building equipment, and Vahey giving in payment $5,000 in land, $2,500 in trucks and $7,500 in cash. Morrison pays $15,000 cash for the remaining 200 shares.

Required:

(*a*) Prepare opening entries in journal form.

(*b*) Find the net worth of the corporation and the book value per share of stock at the end of the year assuming that profits amount to $15,000.

(*c*) How much will each stockholder receive if a dividend of $25 a share is paid?

EXERCISE 25-g

A and B, who have been in the automobile business, and C, a retired bank president, form a corporation for the purpose of carrying on a taxi and express business. Capital stock is issued as follows:

A — 50 shares in payment for taxi-cabs.
B — 50 shares in payment for cars and express trucks.
40 shares in payment for garage and equipment.
10 shares for cash.
C — 100 shares for cash.

The par value of the stock is $100, the total authorized capital being issued at this time. At the end of the first year a 6% dividend is paid.

Required:

(*a*) Entries in journal form to record issue of stock and payment of incorporation fee of $\frac{1}{20}\%$ in cash.

(*b*) Find the amount of dividend each stockholder will receive.

QUESTIONS FOR DISCUSSION

1. Explain why it is, or is not, necessary to have an entirely new set of ledger accounts for a corporation.

2. In what respect is the Capital Stock account in the ledger of a corporation similar to the partners' Capital accounts in a partnership?

3. When a corporation issues both common and preferred stock, how is the capital recorded in the ledger?

4. What information should the opening entry for a corporation show?

5. May capital stock be issued for anything except cash? Explain.

6. Explain what is meant by the Capital Stock account in the General Ledger being a controlling account for the Stockholders Ledger.

7. When the capital stock of a company is not all issued, how may the total amount that the company may issue as well as the amount not issued be shown?

8. If the authorized capital stock of a company is $25,000 and the issued stock is $10,000, how is the difference accounted for?

9. Which should be shown in the balance sheet, the authorized, unissued, or issued and outstanding stock?

10. What is meant by "organization" expenses? How do they differ from ordinary expenses and what is the justification for capitalizing them and carrying them as an asset?

11. What final disposition is made of organization expenses?

12. Explain the advantages, if any, of owning the preferred stock in Exercise 25-c.

CHAPTER XXVI

CAPITAL STOCK ACCOUNTS (CONTINUED)

Subscriptions to Capital Stock. — When a person signs a subscription blank agreeing to buy the number of shares set opposite his name, it becomes a claim against him in the same manner as a claim for goods purchased. However, instead of including these claims with the regular Accounts Receivable a separate *Subscriptions Receivable* account is used. When the capital stock of a corporation is all subscribed, paid for in cash or property, and stock certificates issued, the only entry necessary is to debit Cash and credit Capital Stock as explained in the previous chapter, and no entry is necessary for Subscriptions Receivable. However, if any time elapses between the date of subscription and the date of payment, it is necessary to debit the Subscriptions Receivable account and credit Capital Stock Subscribed account until payment is made and the shares issued, at which time the Capital Stock Subscribed account is debited and Capital Stock account (or Unissued Capital Stock account) credited.

Subscriptions Receivable Account. — This account is used to indicate the amount due from subscribers. It is debited for the total amount of stock subscribed as shown by the subscription blanks and is credited for payments on account of these subscriptions as shown by the Cash Receipts Journal. The balance represents the amount due from subscribers and is shown in the balance sheet as a current asset. Subscriptions Receivable is a controlling account for the Subscription Ledger described on page 249 where detailed accounts are kept with the various subscribers.

Capital Stock Subscribed Account. — This account is debited for the par value of stock recorded in the Subscriptions Receivable account, *when issued;* at which time Capital Stock or Capital Stock Unissued is credited, depending upon which method is used. The account is credited for the par value of capital stock subscribed, *when sold;* at which time Subscriptions Receivable is debited. The balance of the account represents the amount of stock subscribed but not issued and is shown in the capital section of the balance sheet.

Illustration

On November 1, 19 — the Owen Trading Co. is incorporated with an authorized capital stock of $50,000, par value of shares $100. The stock is fully

subscribed at par, payable in 30 days. On December 1, payment for all subscriptions is received in cash and stock certificates are issued to all subscribers.

Inasmuch as 30 days' time elapses between the date of subscription and the date of payment for, and issue of, the stock a Subscriptions Receivable account is opened. The entries in journal form are as follows:

November 1, 19—		
Subscriptions Receivable	$50,000.00	
Capital Stock Subscribed		$50,000.00
To record the sale of stock as per subscription list.		
December 1, 19—		
Cash	50,000.00	
Subscriptions Receivable		50,000.00
To record payment for stock subscribed November 1.		
Capital Stock Subscribed	50,000.00	
Capital Stock		50,000.00
To record issue of stock certificates to subscribers.		

Thus far the use of three capital stock accounts has been illustrated: Capital Stock, Capital Stock Subscribed and Capital Stock Authorized. Each of these accounts stands for something definite. *Capital Stock* refers to stock subscribed (sold), paid for, and issued. *Capital Stock Subscribed* refers to stock subscribed (sold), but not issued. It may, however, be partially paid for, when payments are to be made in instalments. *Capital Stock Authorized* refers to the total capital stock the corporation is authorized to issue under its charter.

Treasury Stock and Capital Stock Donated Accounts. — As stated in a previous chapter, stock that has once been issued and which has come back into possession of the corporation either through donation or through purchase is known as treasury stock. A *Treasury Stock* account is kept to record the amount of such stock on hand. This account is debited when the stock is acquired, at which time *Capital Stock Donated* account is credited if the stock is donated or Cash is credited if the stock is purchased. Treasury Stock account is credited when such stock is disposed of. The balance represents the par value of the shares of such stock in the hands of the treasurer.

Shares of capital stock are sometimes donated to the company so that they may be sold to raise working capital. Assuming that stockholders donate to a

corporation $25,000 of stock to be sold to raise working capital, the entry to record the receipt of the stock is as follows:

Treasury Stock	$25,000.00	
Capital Stock Donated		$25,000.00
To record receipt of donation of stock from stockholders.		

This is a memorandum entry made for the purpose of bringing into the ledger the par value of shares donated. At the time the stock is sold the entry is as follows:

Cash	$25,000.00	
Donated Surplus		$25,000.00
To record sale of donated stock at par.		

The following entry is then made to remove the treasury stock from the books:

Capital Stock Donated	$25,000.00	
Treasury Stock		$25,000.00
To reverse memo. entry, stock having been disposed of.		

Stock donated for the purpose of raising working capital is usually sold at less than par. Assuming that the above stock is sold at $80 per share, the entry in the Cash Receipts Journal to record the sale is as follows:

Cash	$20,000.00	
Donated Surplus		$20,000.00
To record sale of donated stock at $80 per share.		

The original entry is then reversed in the same manner as before:

Capital Stock Donated	$25,000.00	
Treasury Stock		$25,000.00

From the above it is seen that the Capital Stock Donated account is debited when treasury stock donated is disposed of and credited when such stock is acquired. The balance will be the same as that of Treasury Stock account provided no treasury stock has been purchased.

Occasionally a corporation purchases some of its own stock. The law in some states forbids a corporation dealing in its own stock so that when purchased the stock is retired and Capital Stock account debited. However, assuming that a corporation purchases $10,000 of its own stock at par with the idea of disposing of it again, the entry is:

Treasury Stock	$10,000.00	
Cash		$10,000.00
To record purchase of 10 shares of company stock at par.		

If this stock is purchased below par the difference between the amount paid and par value is credited to Surplus account. If purchased above par the difference is debited to Surplus account. Thus, if the stock in the foregoing illustration is purchased at $9,500 the entry is as follows:

Treasury Stock	$10,000.00	
Cash		$9,500.00
Surplus		500.00

If this stock is later sold for $9,000 the entry is as follows:

Cash	$9,000.00	
Surplus	1,000.00	
Treasury Stock		$10,000.00

Treasury stock is shown in the balance sheet as a deduction from stock issued in the following manner:

Capital:			
Capital Stock Issued	1000 Shares	$100,000.00	
Less-Treasury Stock on Hand	100 "	10,000.00	
Capital Stock Outstanding	900		$90,000.00

EXERCISE 26-a

The Newton Machine Co. is incorporated under date of Jan. 1, 19— with an authorized capital stock of $25,000, par value of shares $50. The stock is fully subscribed payable in 60 days. At the end of the 60 days cash is received for all subscriptions and stock certificates are issued. Expenses incidental to incorporation amounting to $250 are paid in cash.

Required:

Entries in journal form to record above facts.

EXERCISE 26-b

The Ajax Mining Co., needing additional capital, receive authority to issue additional common stock amounting to $50,000, par value $25. The stock is all subscribed on July 1, 19— to be paid one-half in cash and the balance as needed by the directors. The cash payment is made and one month later the directors issue a call for one-half the remainder which is paid in cash.

Required:

Entries in journal form to record the above facts.

EXERCISE 26-c

On April 1, 19—, the X Mfg. Co. stockholders donated 200 shares of stock, par value $100, to be sold to raise working capital. This stock was later sold at $75.

Required:

Entries to record the foregoing facts.

EXERCISE 26-d

The Jenkins Sales Co. desires to retire a part of its stock and purchases 5,000 shares at $60. The par value of this stock is $50.

Required:

(*a*) Entry to record purchase of stock.

(*b*) Assuming that the stock was purchased at $40, show the entry.

EXERCISE 26-e

J. T. Stuart, Inc., has received from a stockholder 100 shares of stock, par value $50, to be sold to secure additional working capital. The business shows a suddenly increased activity and within a month 75 shares of this stock are sold at $80 a share, cash being received and certificates issued.

Required:

(*a*) Entries to record receipt of stock and subsequent sale.

(*b*) Assuming that the remaining 25 shares are issued again to the original stockholder, no payment being made by him for same, what entries will be necessary to record the issue of this stock?

EXERCISE 26-f

F. A. Bonnar, who has been carrying on a merchandising business under an individual proprietorship, wishes to form a corporation together with J. C. Burns and W. C. Thompson. The corporation is formed on July 1, 19— with an authorized capital of $100,000 divided into shares of $100 each. Stock certificates are issued as follows:

F. A. Bonnar, 125 shares in exchange for $10,000 in merchandise, and $2,500 in store equipment.

J. C. Burns, 75 shares in exchange for $5,000 cash and $2,500 in trucks.

W. C. Thompson, 50 shares in exchange for $5,000 cash.

Also, 500 shares are subscribed on July 1 but payment in full is not received until August 15, at which time stock certificates are issued. The remaining 250 shares are not subscribed until September 1 and payment is to be made in two equal instalments on October 1 and November 1. These payments are made as agreed and on November 1 all stock certificates are issued.

Required:

(*a*) Entries to record above transactions. (Unissued stock account not used.)

(*b*) Set up ledger accounts, five to page, post the above entries and take a trial balance.

EXERCISE 26-g

Rosane & Knapp, Inc. was incorporated on August 1, 19— with an authorized capital stock of $100,000 divided into 500 shares common stock and 500 shares preferred stock, par value $100. 5 shares of common stock were issued to each of the three incorporators for cash. 100 shares of common and 100 shares of preferred stock were issued in exchange for patent rights. 5 shares of preferred stock were issued to a lawyer as compensation for legal services in forming the corporation. 5 shares of preferred stock were issued to a broker for selling the stock of the corporation. 200 shares of common stock and 200 shares of preferred stock were issued for cash. 100 shares of preferred stock and the balance of the common stock were subscribed for, payment to be made in two equal instalments on August 15 and September 1.

On August 15 the instalment due was paid in full. On September 1 the instalment due was paid with the exception of 25 shares of preferred stock. Certificates were issued for all paid-up stock.

Required:

(*a*) Entries to record above transactions. (Unissued stock account to be used.)

(*b*) Set up ledger accounts, five to page; post the above entries and take a trial balance.

QUESTIONS FOR DISCUSSION

1. What do you understand by "subscriptions to capital stock" and how are they obtained?
2. When is the use of a Subscriptions Receivable account recommended?
3. Since stock must be subscribed in every corporation that is formed, why is the account Subscriptions Receivable not used in some instances? Explain fully.
4. What is the difference between treasury stock and unissued stock?
5. Subscriptions Receivable account is debited and Capital Stock Subscribed account is credited when stock is sold. Will the balances of these accounts always be the same amount?
6. What account is credited when Capital Stock Subscribed account is debited?
7. May the Unissued Stock account and the Treasury Stock account appear on the books at the same time? Explain.
8. Explain the difference between the following accounts: Capital Stock, Capital Stock Subscribed, Capital Stock Authorized, and Capital Stock Donated.
9. When a company buys its own stock with the intention of retiring it, what entry is made?
10. For what purpose is stock usually donated to a corporation?

CHAPTER XXVII

THE DISTRIBUTION OF SURPLUS

Surplus Account. — At the close of the fiscal period, the entries to close the ledger of a corporation are practically the same as those for a partnership or individual proprietorship. All *nominal* accounts are closed into Profit and Loss account, the expenses being debited and the income items credited to that account. The Profit and Loss account, however, is closed into a Surplus account instead of into the partner's or proprietor's capital or current account. The term " surplus " as applied to corporations refers to the *excess* of the *net worth* of the corporation over the *par value* of the *capital stock issued* as shown by the Capital Stock account.

For instance, if a corporation is organized with a paid-in capital stock of $100,000 and at the end of the first year has made a profit of $20,000, the net worth of the corporation is $120,000 and the difference between that amount and the $100,000 capital stock is the surplus. After closing the ledger in the usual manner, the balance of Profit and Loss account shows a credit of $20,000 which is closed to the Surplus account in the following manner:

Profit and Loss	$20,000.00	
Surplus		$20,000.00
To close net profit for the year into Surplus account.		

In the foregoing illustration, if the corporation loses $20,000 during the year instead of making a profit of that amount the net worth at the close of the year is $80,000 and the difference between that amount and the $100,000 capital stock represents a deficit or impairment of capital. The Profit and Loss account then shows a debit balance of $20,000 which is closed into Surplus or into a special *Deficit* account.

The profit or loss for the year, and also any changes in net worth during the year not due to current expenses or income, are recorded in the Surplus account. All distributions of earnings to the stockholders in the form of dividends are charged to this account. The Profit and Loss account summarizes the expenses and income for the *current period*, the balance representing the net profit or net loss for that period. The Surplus account summarizes the profits of

previous periods retained in the business and any changes in net worth not due to normal operations. The debits and credits to this account are summarized as follows:

SURPLUS

Debit:	*Credit:*
At the close of the fiscal period with net loss as shown by the balance of the Profit and Loss account.	At the close of each fiscal period with net profit as shown by the balance of the Profit and Loss account.
With dividends declared as shown by the Minute Book and Dividend record.	With any adjustments or corrections which increase the profits of previous periods.
With profits withheld for some special purpose and transferred to a special account.	
With any adjustments or corrections which decrease the profits of previous periods.	

The balance of the account, if a credit, represents the amount of profits retained in the business and is an addition to capital. It is shown in the capital section of the balance sheet as follows:

Capital:		
Capital Stock Outstanding (1,000 shares)	$100,000.00	
Surplus	20,000.00	
Net Worth		$120,000.00

When Surplus account shows a debit balance, it represents a deficit and whether allowed to remain in that account or transferred to a special Deficit account it is shown in the balance sheet as follows:

Capital:		
Capital Stock Outstanding (1,000 shares)	$100,000.00	
Less-Deficit	20,000.00	
Net Worth		$80,000.00

Dividend Account. — The directors have the power to distribute the surplus to the stockholders in the form of dividends or, if they consider it for the best interests of the corporation, they may retain the surplus in the business. A stockholder cannot compel a distribution of surplus unless it is shown that there

is fraud of some kind. If the directors decide to make a distribution of profits, a meeting of the directors is called and a motion is made that a dividend of a stated amount be declared. This motion, being voted upon and carried, is recorded in the minutes of the meeting by the secretary. An entry is then made in the journal to show the action of the directors. Assuming that in the case of the corporation referred to on page 231, a dividend of 10% is declared, the entry is made as follows:

Surplus	$10,000.00	
Dividends Payable		$10,000.00
To record declaration of dividend of 10% on capital stock of $100,000 outstanding payable in cash to stockholders of record on December 31, 19—.		

When the dividend is paid on the date specified the entry is made in the Cash Payments Journal as follows:

Dividends Payable	$10,000.00	
Cash		$10,000.00
To record payment of dividend #1 declared on December 31, 19—.		

This dividend is paid to the stockholders owning stock on December 31, 19— as shown by the dividend list, prepared from the Stockholders Ledger, as shown on page 252.

The Dividend account is, therefore, debited for the total amount of dividend paid at the time of payment and is credited for the total amount of dividend declared at the time of declaration as shown by the Minute Book. The balance of this account represents unpaid dividends; it is a current liability of the corporation and will be shown among the current liabilities in the balance sheet. Separate dividend accounts are provided for preferred and common stock.

Stock Dividend. — A dividend declared by the directors becomes a current liability of the corporation and has the same status as Accounts Payable. This liability is usually paid in cash, but the corporation may use any of its property to pay the dividend. Most states also permit the issue of capital stock to pay dividends. For instance, a corporation having authorized unissued stock of $100,000 and a balance in the Surplus account of $50,000 decides to declare a dividend payable in capital stock for $50,000. The entry for the declaration of the dividend is as follows:

Surplus	$50,000.00	
Stock Dividend Payable		$50,000.00

When the stock is issued to pay the dividend the entry is as follows:

Stock Dividend Payable	$50,000.00	
Capital Stock		$50,000.00

The effect of a stock dividend such as above is to convert surplus, which may be paid out in cash, into fixed capital and thus place the corporation in a stronger financial position. If a corporation has issued all its authorized stock and wishes to declare a stock dividend it will be necessary to secure from the state permission to increase its authorized stock.

Donated Surplus Account. — In order to keep that part of surplus that has not been earned by the business separate from the accumulated earnings an account is sometimes kept with Donated Surplus. This account is credited with the proceeds realized from the sale of donated capital stock, known as treasury stock, and with the value of donated land or other property sometimes offered to a corporation as an inducement to locate in a city or town. This account is debited whenever any of this surplus is appropriated for a special purpose or is transferred to some other account. While dividends may be paid from this surplus legally, it is considered poor policy to do so as all items credited to this account have been donated for the purpose of raising working capital. The balance of this account represents the unearned profits accumulated by the corporation and is shown in the capital section of the balance sheet before the earned surplus as follows:

Capital:		
Capital Stock Issued (1,000 shares)	$100,000.00	
Donated Surplus	5,000.00	
Surplus	20,000.00	
Net Worth		$125,000.00

Capital Stock Premium. — When stock is sold at more than par value, the excess is carried to a separate account. This is sometimes credited to Surplus account but it is better to credit the premium to an account called either Capital Surplus or Capital Stock Premium. It represents paid-in capital and should not be used for dividends but carried as a part of capital. For instance, a corporation sells 100 shares of its capital stock at $102 per share; the entry is as follows:

Cash	$10,200.00	
Capital Stock		$10,000.00
Capital Stock Premium		200.00
To record sale of 100 shares of stock at $102.		

In most states it is illegal to sell the original issue of stock at less than par; therefore, a Discount account is unnecessary. All surplus items with the exception of earned surplus, from which dividends should be paid, may be recorded in one account designated as *Capital Surplus.*

EXERCISE 27-a

The Newton Foundry Co. at the time of closing its books on December 31, 19— finds its net profit to be $4,630.40, this being the credit balance of the Profit and Loss account. The Surplus account at this date shows a credit balance of $2,400. The directors declare an annual dividend of 6% on their capital stock outstanding amounting to $100,000, payable in cash on January 15, 19— to stockholders as of December 31, 19—

Required:

Journal entries to record the declaration and payment of the dividend.

EXERCISE 27-b

A corporation closes its books on December 31, 19—, the net profit for the year being $6,450. The directors at this time declare a semiannual dividend of $3\frac{1}{2}\%$ on the preferred stock of $50,000 and 3% on the common stock of $25,000, payable on January 10, 19— to stockholders of record on December 31, 19—.

Required:

Journal entries to record the closing of the Profit and Loss account and the declaration and payment of the dividend.

EXERCISE 27-c

The surplus of the Chambers-Smith Co. at the end of the fiscal year amounts to $94,500. On June 30 the directors declare a dividend of 8%, payable on July 10. The authorized capital stock of the company is $200,000 consisting of 2,000 shares, par value $100. There are 1,500 shares outstanding, 300 shares unissued, while 200 shares are in the treasury, having been donated to provide working capital. The above dividend is paid when due.

Required:

Prepare journal entries to record declaration and payment of the dividend.

EXERCISE 27-d

The capital of a corporation is made up of $500,000 common stock and $250,000 6% cumulative preferred stock. The profits for the year 19— were $85,000. The preferred dividends are two years in arrears. The directors decide to distribute the entire profits for the year to the stockholders and make the formal declaration as of December 31, payable in cash on January 15.

Required:

(*a*) Journal entries to record the declaration and payment of the dividends.

(*b*) Rate of dividend received by the common stockholders.

EXERCISE 27-e

The Browning Mfg. Co. with capital stock outstanding of $300,000 having accumulated a surplus of $200,000, the directors decide to increase the capital stock to $500,000 by the declaration of a stock dividend for the amount of the surplus. This is done accordingly on December 31 and the stock issued on January 10, permission having been secured from the state officials to increase the authorized issue of stock to $500,000.

Required:

(*a*) Entries to record declaration and payment of the dividend.

(*b*) Set up the capital section of the Browning Mfg. Co. balance sheet before and after the payment of the dividend.

EXERCISE 27-f

The Atlas Company was formed January 1, 19— with an authorized capital stock of $250,000 (2,500 shares par value $100) and issued the entire amount to A, B, C and D equally in payment for patents and property. Each stockholder then donated one-fifth of his stock to the company in order that it might be sold to secure working capital. Stock was sold as follows:

January	5	100 shares	at	$65.00
	15	50 "	"	75.00
	20	125 "	"	72.50

On February 1 the corporation bought the 50 shares sold on January 15 at $70 a share and resold them on February 5 at $75.

Required:

(*a*) Journal entries to record the formation of the Atlas Company together with subsequent transactions.

(*b*) Balance sheet on February 5, taking into consideration the above items only.

EXERCISE 27-g

January 15, 19—, the Norwood Mfg. Co., received its certificates of incorporation authorizing an issue of 500 shares of 6% preferred stock and 500 shares of common stock, par value $100 per share. The incorporators agreed to take 300 shares of preferred stock and 200 shares of common stock at par, and paid the treasurer 20% of the amount subscribed in cash. Organization expenses amounting to $500 were paid.

January 30, 19—, the corporation purchased a patent from one of the incorporators for $50,000 on the following terms: $25,000 in common stock of the company; $5,000 in cash; and a note for $20,000 payable on demand with interest at 6%. They also purchased for cash office equipment costing $1,000.

April 1, 19—, the treasurer received in cash the balance of 80% owing by the subscribers to capital stock. The stock being fully paid certificates were issued to all subscribers.

July 1, 19—, the company sold for cash 100 shares of preferred stock at 103 and issued the certificates.

December 31, 19—, products covered by the patent were marketed jointly with the Jones Mfg. Co. through the latter's factory. The Norwood Mfg. Co.'s share of the profits amounted to $20,000, which was received in cash. Interest, salaries, and other expenses amounted to $12,000 for the year. The note of January 30 was paid in cash. The directors declared a dividend of 6% on the preferred stock, and 5% on the common stock, payable January 15, to those owning stock on December 31, 19—.

Required:

(*a*) Journal entries covering the above transactions.

(*b*) Post entries in (*a*) to a ledger (five accounts to a page), close the ledger and prepare a trial balance after closing.

QUESTIONS FOR DISCUSSION

1. In what particular does the closing of the ledger of a corporation differ from the closing of that of a partnership?
2. What is meant by the terms "surplus" and "deficit" as applied to corporations?
3. How does the Surplus account differ from the Profit and Loss account?
4. Are the directors of a corporation obliged to distribute all the earnings to the stockholders in the form of dividends?
5. Outline the procedure for the declaration and payment of a dividend.
6. Must all dividends be paid in cash?
7. What is meant by a stock dividend?
8. What is the effect of a stock dividend upon the net worth of a corporation?
9. How are those to whom a dividend should be paid determined?
10. What is the purpose of a Donated Surplus account?
11. Under what circumstances is an account with Capital Stock Premium used?
12. May dividends be declared from Donated Surplus and Capital Stock Premiums?
13. What is meant by capital surplus?
14. Why is an account not needed in most states for capital stock discounts?
15. Why is a dividend not usually payable on date of declaration?

CHAPTER XXVIII

ACCOUNTS WITH CORPORATE BONDS

Bonds Defined. — Bonds are issued by a corporation to procure funds for the financing of the business in addition to those invested by the stockholders. They are long-term obligations, the term varying in length from ten to fifty years, and are usually issued in denominations of $100, $500 or $1,000. The bonds contain the corporation's promise to pay their face value to the holder at a fixed future date and to pay interest, usually semiannually, at a stated rate during the life of the bond. They are similar to notes but issued for a longer term, and are usually secured by the assets of the corporation.

Bonds may be either *registered* or *coupon.* In the case of *registered bonds* the owner's name is recorded on the books of the issuing company, and payment of interest is made by checks drawn in the owner's favor. A *coupon bond* is payable to bearer and is transferable by delivery. Such bonds have attached to them coupons for the interest payments to be made during the life of the bond. For instance, a $500 coupon bond payable in 20 years with interest at 6%, payable every six months, has attached to it forty coupons each calling for a payment of $15. The coupons are detached and collected as they mature, usually by depositing them in the local bank of the holder, which forwards them to whatever bank has agreed to act as financial agent for the bonds. The name of the financial agent appears on the coupon. The issuing corporation deposits with the financial agent at each interest date the amount of money required to meet the interest coupons which will be presented to it.

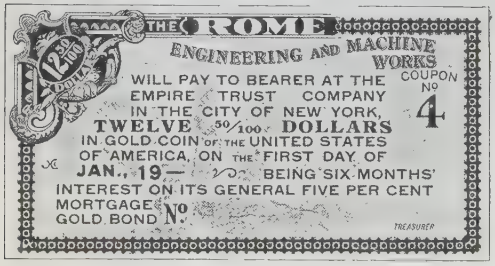

THE ROME ENGINEERING AND MACHINE WORKS
WILL PAY TO BEARER AT THE EMPIRE TRUST COMPANY IN THE CITY OF NEW YORK,
TWELVE 50/100 DOLLARS
IN GOLD COIN OF THE UNITED STATES OF AMERICA, ON THE FIRST DAY OF
JAN., 19— AND BEING SIX MONTHS' INTEREST ON ITS GENERAL FIVE PER CENT MORTGAGE GOLD BOND No
COUPON No 4
TREASURER

Illustration — A Bond Coupon

Bonds Compared with Capital Stock. — From the standpoint of the corporation the main difference lies in the fact that the bondholder is a creditor, and generally a secured creditor, while the stockholder is one of the owners of the business. The bond interest payment must be made at the stated date or the bondholders may take possession of the company's property if the bonds are

secured by a mortgage on it, while dividends are only payable when they are declared by the Board of Directors, and they cannot be declared legally unless the company has made a profit. Interest on bonds is an expense of the business while dividends are a distribution of profits.

From the investor's standpoint the bond is considered a safer investment than capital stock but, as an off-set to the greater degree of safety, it usually pays a smaller return on the investment. Regardless of the profits of the company the bondholder never receives more than his stated rate of interest whereas the stockholder, in times of prosperity, may expect to receive higher rates of dividend. The bondholder has no voice in the management of the corporation (except, under certain conditions, when interest on bonds is in default) while the stockholder exercises his influence in the corporate management through his vote.

Bonds Payable Account. — The bookkeeping entries for issuing bonds are somewhat the same as those for issuing stock. The authority to issue bonds is usually delegated to the Board of Directors by the stockholders. When a bond issue is authorized a proper record of the action of both the stockholders and the directors is made in the Minute Book of the corporation. The entry in the financial books is not usually made until the bonds are sold. An account is then opened with Bonds Payable giving the official title of the bonds. This account is credited with the par value of bonds issued and debited with the par value of bonds paid off and retired. The balance of this account is always a credit and represents the amount of bonds outstanding. It is a fixed liability and appears in the balance sheet under that heading.

To illustrate, suppose X Corporation borrows $500,000 through a 20-year bond issue secured by a first mortgage on its plant, interest to be paid semi-annually at the rate of 7%.

The following entry is made when the bonds are issued.

Cash	$500,000.00	
First Mortgage 7% Bonds Payable		$500,000.00
To record the sale of bond issue at par for cash.		

At the end of twenty years when the bonds are paid off and retired the entry is as follows:

First Mortgage 7% Bonds Payable	$500,000.00	
Cash		$500,000.00
To record payment of cash to retire bond issue.		

United States of America.

STATE OF NEW YORK.

No. 15

ROME ENGINEERING AND MACHINE WORKS

500

GENERAL MORTGAGE FIVE PER CENT GOLD BOND

To Bearer

Rome Engineering and Machine Works

to pay to the bearer, or if registered, to the registered owner

FIVE HUNDRED DOLLARS

in gold coin of the United States of the present standard of weight and fineness, with interest thereon at the rate of five per cent per annum from the date hereof, payable by the Company in semi-annual installments on the first days of January and July in each year upon presentation and surrender of the annexed coupons as they severally become due, and shall be paid; provided, however, that the principal hereof may be paid and redeemed at any time after the first day of January, A.D. 1900, at the option of the Company, upon the payment of five per cent as provided in the mortgage hereinafter mentioned.

This bond is one of a series of bonds issued and to be issued by the Rome Engineering and Machine Works, a corporation duly organized and existing under the laws of the State of New York, to the amount of one million dollars, all of like tenor and effect except as to the number and amount, and all issued and to be issued under and secured by a mortgage executed by the said Rome Engineering and Machine Works to the Rome Trust Company, as trustee, dated the first day of January, A.D. 1899, and duly recorded in the office of the clerk of the county of Oneida, in the State of New York, on the second day of January, A.D. 1899, to which mortgage reference is hereby made for a description of the property mortgaged, the nature and extent of the security, the rights of the holders of said bonds and the rights, duties and obligations of the said Rome Engineering and Machine Works and of the said trustee under such mortgage.

In Witness Whereof the said Rome Engineering and Machine Works has caused its corporate seal to be hereunto affixed, and these presents to be signed by its President and countersigned by its Secretary, this second day of January, A.D. 1899.

Rome Engineering and Machine Works.

President.

Secretary.

Bond Premium and Discount. — Because of the financial situation at the time the bonds are issued, the method of disposing of the bonds, and the rate of interest to be paid on the bonds, etc., a bond issue is frequently sold at above par (at a premium) or below par (at a discount). The premium or discount is usually expressed in a percentage, 100 being par. Thus, 102 represents 2% premium while 98 represents 2% discount. Bonds are always recorded on the books of the issuing company at par. Therefore, when sold at a premium or discount, accounts with Bond Premium or Bond Discount, as the case may be, are used to record the difference between the sale price and the face or par value.

For instance, in the foregoing illustration of X Corporation, if the bonds are sold at 102 the entry is as follows:

Cash	$510,000.00	
First Mortgage 7% Bonds Payable		$500,000.00
Premium on First Mortgage 7% Bonds Payable		10,000.00
To record sale of bonds issued at 102 for cash.		

On the other hand, if these bonds are sold at 98 the entry is as follows:

Cash	$490,000.00	
Discount on First Mortgage 7% Bonds Payable	10,000.00	
First Mortgage 7% Bonds Payable		$500,000.00
To record sale of bonds issued at 98 for cash.		

When the bonds are retired the entry is the same as that shown on page 239. They must be paid off at the par or face value.

The bond premium or bond discount operates as a reduction or an increase in the cost of carrying the bonds. A proportion of the premium or discount is written off each year during the life of the bonds and considered as interest. The amount written off represents an adjustment of the interest paid on the bonds. In the case of 20-year bonds one-twentieth of the amount may be written off each year. The entry then at the end of each year for the bonds of the X Corporation shown above when sold at a premium is:

Premium on First Mortgage 7% Bonds Payable	$500.00	
Interest on First Mortgage 7% Bonds Payable		$500.00
To write off $\frac{1}{20}$ of premium from sale of bonds.		

When sold at a discount the entry is:

Interest on First Mortgage 7% Bonds Payable	$500.00	
Discount on First Mortgage 7% Bonds Payable		$500.00
To write off $\frac{1}{20}$ of discount from sale of bonds.		

The balance of the premium account at the end of each period is considered as deferred income and is shown on the liability side of the balance sheet, while the discount account is considered as deferred expense and is shown on the asset side of the balance sheet.

Bond Interest. — The Bond Interest account is handled the same as any other interest expense account, being charged with interest paid and accrued and credited with any reductions in the interest charged. In the illustration of the X Corporation, if the interest payments are to be made April 1 and October 1 (assuming the bonds to have been issued on April 1) the entry to be made on October 1 and at the end of each six-month period thereafter is as follows:

Interest on First Mortgage 7% Bonds Payable	$17,500.00	
Cash		$17,500.00
To record payment of semiannual interest on bonds at 7%.		

The interest is always figured on the face of the bonds no matter what the sale price of the bonds may be. The interest paid in cash less a proportion of bond premium or plus a proportion of the bond discount is a financial expense and is shown in the profit and loss statement under Other Expenses.

Bond Sinking Fund. — In order to make certain that cash will be available to pay off the bond issue when it falls due, it is sometimes provided that funds shall be set aside each year during the life of the bonds for this specific purpose. The fund so accumulated is known as a Bond Sinking Fund. The amount to be set aside each year is found (1) by dividing the number of years the bonds have to run into the face of the bonds, or (2) by setting aside each year an amount which invested at a given rate of interest will amount to the face of the bonds at the time the bonds mature.

Assuming that the first method is used in the case of the X Corporation, the entry at the end of each year is as follows:

Bond Sinking Fund	$25,000.00	
Cash		$25,000.00
To provide sinking fund for retirement of bond issue.		

During the life of the bonds the Bond Sinking Fund is shown in the balance sheet as an asset. At the end of the twenty years when the bonds fall due the accumulated fund is used to pay off the bonds and the following entry is made:

First Mortgage 7% Bonds Payable	$500,000.00	
Bond Sinking Fund		$500,000.00
Bond issue retired from funds accumulated for that purpose.		

The conditions under which the bonds are issued sometimes provide additional security for the payment of the bonds by requiring that an amount equal to the deposit in the sinking fund shall be withheld from the profits each year and transferred to a Reserve for Bond Sinking Fund account. This is for the purpose of preventing the distribution of all the annual profits to stockholders in the form of dividends and thus holds in the business a portion of profits equal to the deposit in the sinking fund so as not to deplete the working capital of the concern.

Assuming that the amount to be set aside is to be equal in amount to the annual contribution to the sinking fund, the entry at the end of each year is as follows:

Surplus	$25,000.00	
Reserve for Bond Sinking Fund		$25,000.00
To record the annual transfer of profits to a special reserve in accordance with terms of bond issue.		

Under this method, after the bonds have been paid off from the sinking fund at the end of the twenty years, there is no further use for the Reserve for Bond Sinking Fund and an entry is then made to transfer same to surplus as follows:

Reserve for Bond Sinking Fund	$500,000.00	
Surplus		$500,000.00
To transfer to Surplus the sinking fund reserve, bonds having been retired.		

The Reserve for Bond Sinking Fund, being a part of the surplus of the corporation, is shown in the capital section of the balance sheet.

EXERCISE 28-a

The Hayes-Brown Co. authorizes an issue of $100,000 of 6% First Mortgage Bonds payable in ten years, interest payable semiannually. The entire issue is sold at par for cash

Required:

Journal entries to record (*a*) The sale of the bonds for cash.

(*b*) The payment of the semiannual interest.

(*c*) The retirement of the bonds at the end of the ten years if paid in cash.

EXERCISE 28-b

The directors of the Provident Manufacturing Company voted to issue $150,000 General Mortgage 5% Bonds under date of July 1, 19—, due in 20 years, interest payable semiannually. The entire issue is sold at par and payment received in cash.

Required:

(*a*) Make proper entry to record issue of bonds.

(*b*) Make entry for the first semiannual interest payment.

(*c*) Assuming above bonds were sold at 104, set up journal entry to record sale.

(*d*) Assuming sale of bonds to be made as indicated in (*c*), set up the journal entry that would be made annually to write off the proper proportion of the bond premium.

(*e*) Assuming that the bonds were sold at 98, set up journal entry to record the issue.

(*f*) Assuming sale of bonds to be made as indicated in (*e*), set up the journal entry that would be made annually to write off the proper proportion of the discount.

(*g*) Assuming that the Provident Mfg. Company sets aside at the end of each year $7,500 cash for the purpose of providing a sinking fund for the retirement of the bonds, set up the entry in journal form.

(*h*) Set up entry to record payment of the bonds at maturity from the fund provided for this purpose.

EXERCISE 28-c

The Williams Mfg. Company being in need of additional capital, the directors authorize an issue of $200,000 10-year First Mortgage Bonds bearing interest at 7%, payable semiannually. The bonds are sold to a brokerage house at 102. The agreement under which the bonds are issued requires that $20,000 shall be set aside annually from the profits of the business, and a like sum deposited in a sinking fund to be used to retire the bonds at maturity.

Required:

Entries to record (*a*) Sale of bonds to the brokerage house.

(*b*) First semiannual interest payment.

(*c*) Bond premium written off at end of first year.

(*d*) Annual transfer of profits to the Reserve for Bond Sinking Fund account.

(*e*) Annual deposit of cash in sinking fund.

(*f*) Retirement of bonds at maturity.

(*g*) Closing out of reserve account.

EXERCISE 28-d

On October 1, 19— the Brighton Packing Co. was incorporated with an authorized capital of $500,000, par value of shares $100. The corporation took over the plant of Y, valued at $200,000, and issued to him an equal amount of stock. Y donated $40,000 stock to the corporation to be used in providing working capital.

October 15, $30,000 of the stock thus donated was sold at 90% of its par value.

November 1, $250,000 of the unissued stock was subscribed at par, paid for in cash, and the stock certificates issued.

December 1, the remainder of stock was subscribed and a first instalment of 25% paid on account.

January 1, First Mortgage 6% Bonds were authorized by the directors to the amount of $100,000 and were sold at 98.

Required:

(*a*) Journal entries with full particulars for the above transactions.

(*b*) Open ledger accounts, five to page, post the above items, and take a trial balance.

(*c*) Arrange the items in the trial balance in (*b*) in the form of a balance sheet.

(*d*) Interest on the bonds is payable semiannually and the bonds are to be retired in 20 years. Make entries to record payments of interest and adjust bond discount for the first year.

QUESTIONS FOR DISCUSSION

1. What is a corporation bond, and how does it differ from a note?
2. How often is the interest on bonds usually paid?
3. How does a *registered* bond differ from a *coupon* bond?
4. What is meant by a mortgage bond, and how does this mortgage differ from an ordinary real estate mortgage?
5. Explain the difference between corporation bonds and capital stock.
6. Which would you rather own, a $500 bond or five shares of stock of a par value of $100 each? Give reasons.
7. What does the term "First Mortgage 7% Bond" mean?
8. Explain what bookkeeping entries are made when a bond is issued and when it is retired at maturity.
9. Who has authority to issue bonds, the directors or the stockholders?
10. What entry is made other than that in the financial books to record the receipt of the cash and the issue of the bonds?
11. What is meant by *premium* and *discount* as applied to bond issues?
12. If an issue of bonds having a par value of $100,000 is sold for $90,000, which of these amounts must be paid to the bondholders at the maturity of the bonds?
13. What effect does bond premium or bond discount have upon the actual amount of interest expense, taking into consideration the entire life of the bonds?
14. What is a bond sinking fund and how is it created?
15. What is the purpose of transferring some of the profits of the corporation to an account called Reserve for Bond Sinking Fund?
16. When the bonds are paid off what becomes of (*a*) Bond Sinking Fund account, (*b*) Reserve for Bond Sinking Fund account?

SUMMARY OF CHAPTERS XXIV–XXVIII

A corporation is formed by securing a charter from the state which gives a group of persons the privilege of operating as an individual with limited financial liability. The scope of the business is also limited and periodic reports must be made to the state. The capital of the corporation is divided into equal units known as shares of stock. Shares of stock with a stated value are known as par value stock while those with no stated value are known as no par value stock. The members of the corporation own shares of stock in the corporation which owns the assets. Ownership in the corporation is evidenced by stock certificates, the holders of which are known as stockholders. The names of the stockholders do not appear in the General Ledger, the capital stock accounts taking their place.

The procedure for organizing the corporation is determined by the law of the state where formed. The stockholders elect directors who are responsible for the management of the business and who elect officers, usually from their own number, who operate the enterprise.

Shares of capital stock may be divided into two classes; common and preferred. The preferred stock has preference in the payment of dividends and other privileges not accorded the common stock. Profits of the business paid to the stockholders are known as dividends.

The same accounts and the same type of books and records are used for the routine transactions of the corporation as for other types of ownership. Special accounts must be used to record the sale and issue of capital stock, and for the distribution of dividends. The profits are transferred to a Surplus account and then distributed as dividends. Dividends are usually paid in cash but may be paid in property or capital stock of the corporation. When paid in capital stock they are known as stock dividends.

Capital stock once issued by the corporation and reacquired by purchase or gift is known as treasury stock. This stock is either canceled or sold to raise working capital.

Corporate bonds are obligations entered into by a corporation to procure additional funds for financing the business. Interest on these bonds is payable from earnings, usually semiannually. A sinking fund is sometimes provided to accumulate funds to retire the bonds when they become due.

CHAPTER XXIX

SPECIAL CORPORATE RECORDS

Corporation Books and Records. — Because of its peculiar type of legal organization a corporation is obliged to keep two sets of records. One of these consists of the regular accounting system in which the ordinary routine transactions in connection with operating the business are recorded. These books need not differ in form from those of a partnership or an individual proprietor. The ledger contains a few additional accounts peculiar to the corporate form. These have been explained in previous chapters.

The other set of corporate records consists of what are known as the *stock records*. Stock records contain the details of the corporate activities such as the sale, issue and transfer of capital stock; declaration and payment of dividends on capital stock, etc. The number and form of these books depend somewhat upon the size of the corporation, the number of stockholders, etc. Such records are considered so important that in some states certain of them are required by law. The by-laws of the corporation also frequently prescribe what books of this type shall be used. The books of record most generally used are as follows: Minute Book, Subscription Book, Subscription Ledger, Stock Certificate Book, Stockholders Ledger, Stock Transfer Book, and Dividend Book. In a small corporation having few stockholders and where the capital stock is fully paid at the time of organization some of these books may be dispensed with.

Minute Book. — The Minute Book contains a record of the proceedings at the various meetings of the stockholders and Board of Directors. The entries in this book are made by the secretary or clerk of the corporation. It is a very important record as it contains a diary of the company's official acts as adopted from time to time in the meetings of its directors. It contains such important things as the authorization of stock and bond issues, declaration of dividends and other important events in the corporate life of the organization.

No special form of book or ruling is required for this record. Typewritten sheets containing a record of the meetings, each sheet being signed by the secretary, are sometimes pasted in a bound book designed for this purpose. A loose-leaf book is often used for greater convenience in typing, but the bound book is to be preferred as it does not lend itself so easily to substitution and fraud.

A copy of the company's charter and by-laws should be copied or pasted in the front of the Minute Book for ready reference. Following this should appear the minutes of the first stockholders' and first directors' meetings followed by the minutes of all other meetings in regular order. The following form shows the proceedings of the first meeting of the Board of Directors written up:

Boston, Mass., December 31, 19--

At a meeting of the Board of Directors of the BONNAR STUDIO COMPANY held at 164 State Street, Boston, Massachusetts, with the entire board composed of E. J. Bonnar, Clark F. Atwood and George W. Robinson present and voting.

It was unanimously VOTED to proceed with the election of a president by ballot. The whole number of ballots cast were three, all of which were for E. J. Bonnar who was thereupon declared elected and who thereupon accepted his election and entered upon the discharge of the duties of his office.

It was unanimously VOTED that the president and treasurer, and the Board of Directors be authorized to sign the certificate of condition, as required by law.

It was unanimously VOTED, so far as the board of directors of this corporation are legally capable, to adopt and ratify the vote of the stockholders of even date relative to eliminating all the preferred stock of this corporation and one hundred shares of common stock, and the Board of Directors are hereby authorized to sign all necessary papers to carry out this vote.

It was unanimously VOTED to adjourn, whereupon the meeting was adjourned at 11 A.M. on December 31, 19--

(Signed) *Edward M. Jones*
CLERK

ATTEST:
(Signed) *E. D. Green*

Subscription Book. — This record contains a list of the names and addresses of all persons who have agreed to purchase shares of the capital stock of the corporation. It usually consists of loose sheets headed with a contract under which those subscribing agree to purchase and pay for the number of shares set opposite their names. Each sheet contains spaces for the signature and address of the subscribers and the number of shares they agree to buy. When subscriptions are payable on the instalment plan, the date and manner of payment are set forth. These subscription lists, as they are called, are circulated by those interested in forming the corporation, after which they are bound together and form the Subscription Book. The total amount of the subscriptions as

shown by this record forms the basis for the entry in the General Ledger debiting Subscriptions Receivable and crediting Capital Stock Subscribed. A simple form of Subscription List is shown below:

SUBSCRIPTION LIST Sheet No. 1

THE BONNAR STUDIO COMPANY

To be Incorporated under the Laws of Massachusetts

Capital Stock $25,000 Par Value of Shares $50

We, the undersigned, hereby severally subscribe for and agree to take at their par value the number of shares of the capital stock of the Bonnar Studio Company set opposite our respective names, such subscriptions to become due and payable in cash upon demand of the Treasurer of the corporation.

Date	No. of Shares	Amount	Names	Addresses
19--				
Jan. 1	100	5,000	George W. Robinson	Melrose, Mass.
1	50	2,500	Albert C. Brown	Lynn, Mass.
1	25	1,250	C. W. Roberts	60 State St., Boston

Illustration — Form of Subscription Book

Subscription Ledger. — This book contains accounts with each individual subscriber to the capital stock of the corporation when the stock is sold on the instalment plan. Small ledger sheets, or cards, or a bound book may be used for this purpose, each subscriber's account being charged with the par value of the shares subscribed for by him as shown by the Subscription Book and credited with payments on account as shown by the Cash Receipts Journal. A standard ruled ledger may be used for this book. In some instances a more detailed form such as shown below is used:

Name H. C. Foote

Address Windsor, Connecticut

Class of Stock Common Par Value of Shares $100

Date	No. of Shares	Total Charge	INSTALMENTS No.	%	Amount	Due	Date Paid	INSTALMENTS No.	%	Amount	C. B. Fol.	Balance	Remarks
July 1	10	1000	1	50	500 00	July 1	July 1	1	50	500 00		500 00	
			2	25	250 00	Aug. 1	Aug. 5	2	25	250 00		250 00	
			3	25	250 00	Sept. 1	Sept. 10	3	25	200 00		50 00	Balance in 10 days

Illustration — Form of Subscription Ledger

The balance of the account represents the unpaid subscriptions. The total of these balances should agree with the balance of the Subscriptions Receivable account in the General Ledger which is the controlling account for this ledger.

Stock Certificate Book. — This book consists of blank stock certificates with stubs attached, bound in book form, somewhat similar to an ordinary check book. The certificates are numbered serially and are issued to stockholders after their subscriptions have been fully paid. The certificate contains the corporate name and state where incorporated, the name of the stockholder, the number of shares of which he is the owner, and a description of the class of stock. It is usually signed by the president and secretary of the corporation. The stub should be filled out carefully as the information contained thereon is posted to the credit of the stockholder's account in the Stockholders Ledger. The certificates contain a blank form of assignment on the back which is filled out when the owner desires to transfer his stock to another person. When this is done the certificate is returned to the corporation and a new certificate issued to the purchaser. The old certificate is then marked " Canceled " and pasted to its own stub in the Stock Certificate Book. All certificates are thus accounted for. When different classes of stock are issued different kinds of certificates should be used. A form of stock certificate is shown on page 209.

Stockholders Ledger. — This record contains an account with each stockholder showing the total number of shares issued to him, the number canceled or transferred, and the number still standing in his name. The Stockholders Ledger, therefore, is a subsidiary ledger for the Capital Stock account in the General Ledger. The accounts are credited originally from the stubs of the Stock Certificate Book, each stockholder being credited with the number of shares of stock issued to him. The opening entries in the Stockholders Ledger are posted from the Stock Certificate Book; thereafter, the entries are made from the Stock Transfer Book when such a book is used. The entries consist of a *debit* to the seller, or transferor, of the stock, whose name is already in the Stockholders Ledger, and a *credit* to the buyer, or transferee, whose name may or may not appear in the ledger. If the buyer is a new stockholder, a new account must be opened for him. The sum of the balances of the various stockholders' accounts multiplied by the par value of the stock equals the balance of the Capital Stock account in the General Ledger. Separate accounts must be kept in the Stockholders Ledger with different classes of stock. The law in most states requires that this book be kept and in some instances stipulates what information must be contained therein. The following form of Stockholders Ledger gives the information usually required in each account:

Name Geo. W. Holmes

Address 2900 Euclid Ave., Cleveland, Ohio

Class of Stock Common Par Value of Shares $100

Date of Transfer	To Whom Transferred	Certificate Numbers Canceled	Certificate Numbers Reissued	No. of Shares	Date Acquired	From Whom Transferred	Cert. Nos.	No. of Shares
19--					19--			
Dec. 5	R. C. Beach	5	10	100	Nov. 1	Original		
5	Balance		11	100		Issue	5	200
				200				200
					19--			
					Dec. 31	Balance	11	100

Illustration — Form of Stockholders Ledger

Stock Transfer Book. — This book contains all the information regarding the transfer of capital stock, and is required by law in a number of states. Whenever a stockholder sells his stock or any part of it, he signs an assignment blank authorizing the transfer of a certain number of shares of stock from his account to the account of the buyer. When used this book serves as a journal to the Stockholders Ledger, and all entries therein are made from it after the original issue has been entered. The following form of Stock Transfer Book is prescribed by the New York State Comptroller, acting under authority given him by law:

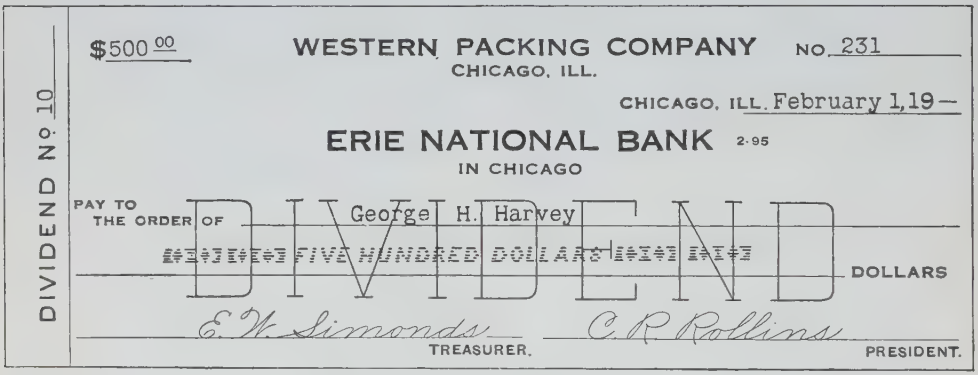
THE PHŒNIX MFG. CO.

Date	Serial No. of Canceled Certificate	Number of Shares	By Whom Surrendered	To Whom Issued	Serial No. of New Certificate	Number of Shares	No. and Face Value of Stamps 2¢	4¢	10¢	20¢	50¢	$1	$2	$10	$20	Value
19--																
June 2	112	50	R. Ames	T. Burr	220	50										
20	140	10	F. Tyler	G. Ely	230	10										

Illustration — Form of Stock Transfer Book

Transfer Agents. — In the case of large corporations whose stock is being transferred frequently, it is customary to appoint transfer agents who have charge of the issue and transfer of stock. They have in charge the Stock Certificate Book, the Stockholders Ledger and Stock Transfer Book, and thus relieve the secretary of the corporation of this detail.

Dividend Book. — This book is used only when dividends are declared and contains a list of the stockholders who are entitled to dividends. It is provided with columns for the name of the stockholder, his address, the number of shares owned by him and the amount of dividend due him. Since most corporations pay dividends by check, a check number column should be provided. A special bank account is sometimes used, the total dividend declared being deposited and special dividend checks drawn in favor of the stockholders.


DIVIDEND No. 10

$500.00 WESTERN PACKING COMPANY NO. 231
CHICAGO, ILL.

CHICAGO, ILL. February 1, 19—

ERIE NATIONAL BANK 2-95
IN CHICAGO

PAY TO THE ORDER OF George H. Harvey

FIVE HUNDRED DOLLARS DIVIDEND DOLLARS

E. K. Simonds TREASURER. C. P. Rollins PRESIDENT.

Illustration — A Dividend Check

The Dividend Book is often made up of loose sheets, the names being recorded therein from the Stockholders Ledger after the stock books are closed.

WESTERN PACKING COMPANY

CAPITAL STOCK $100,000

DIVIDEND NO. 10 SHEET NO. 1

List of stockholders of record as shown by the Stockholders Ledger at the close of business, January 15, 19—, to whom a dividend of 5%, declared December 31, 19—, is payable February 1, 19—:

Shares outstanding 900 Rate of dividend 5%

Name of Stockholder	Address	No. of Shares	Amount of Dividend	Check No.
Geo. H. Harvey	Buffalo, New York	100	500 00	231
C. M. Hunt	" " "	100	500 00	232
Thos. J. Smith	Boston, Mass.	200	1000 00	233

Illustration — Dividend Book

EXERCISE 29-a

May, 19—

1 The Hartford Building Company was organized by Roy Johnson, Ralph Sargent, and James Prescott for the purpose of developing a tract of land owned by Mr. Johnson. The authorized capital stock of the corporation was $75,000 divided into 750 shares, par value $100. Each of the three incorporators subscribed for 150 shares of stock and payment was made on May 1, 19—. Stock certificate No. 1 was issued to Roy Johnson, No. 2 to Ralph Sargent, and No. 3 to James Prescott.

5 One hundred shares of stock were sold to J. W. Baker for cash and stock certificate No. 4 issued to him.

25 The remainder of the stock was issued to Roy Johnson in payment for land transferred by him to the corporation (certificate No. 5).

June, 19—

5 Roy Johnson transferred 75 shares of his stock to J. W. Baker for a private consideration (certificate No. 1 is surrendered by Mr. Johnson and certificate No. 6 reissued to him, while certificate No. 7 is issued to Mr. Baker).

15 James Prescott sold 50 shares of his stock to Ralph Sargent (certificates Nos. 8 and 9) and Roy Johnson transferred 25 of his shares to J. W. Baker (certificates Nos. 10 and 11).

Required:

(*a*) Journal entries to cover above transactions assuming sale of stock to be at par. (Unissued stock account not used.)

(*b*) Trial balance of accounts used in (*a*).

(*c*) Stockholders Ledger carefully designed and written up. In designing this ledger, follow form shown on page 251.

(*d*) List of stockholders, showing number of shares and par value of stock held by each.

EXERCISE 29-b

A corporation sold at par ($50) 1,000 shares of preferred stock on the following terms: 50% to be paid June 1, 25% on August 1, and the balance on October 1. The stock certificates are issued at the time of the final payment.

Required:

Assuming that F. W. Bates, Pittsburg, Pa., subscribed for 200 of the shares referred to above, and that the corporation uses a Subscription Ledger with columnar headings as shown on page 249, design the ledger and record therein the facts pertaining to Mr. Bates' subscription, assuming that he paid the various instalments as they became due.

EXERCISE 29-c

The Robley Mfg. Company was organized on January 1, 19-- with an authorized

capital stock of $200,000 divided into 2,000 shares, par value $100 each. The incorporators, J. K. Cooper, F. C. Andrews and K. D. Browne, subscribed for 20 shares of stock each and made payment in cash on the above date. Stock certificates numbered 1, 2 and 3 were issued to them in the order in which their names appear above. Organization expenses amounting to $1,500 were paid in cash. The following transactions affecting the capital stock accounts took place during the next six months.

January 10, R. L. Mannix purchased 200 shares of stock for cash and received stock certificate No. 4.

February 12, W. D. Thompson purchased 10 shares of stock for cash and certificate No. 5 was issued to him.

March 1, the incorporators subscribed for 400 shares each, payment to be made on April 1.

April 1, the incorporators paid for the stock subscribed on March 1 and stock certificates Nos. 6, 7 and 8 were issued to them.

April 10, the company purchased a building from R. W. Davis for $10,000 and gave in payment 100 shares of stock (certificate No. 9).

May 10, the company purchased patent rights from J. T. Waters and gave in payment 300 shares of stock (certificate No. 10).

May 25, R. L. Mannix sold 75 shares of his stock to J. T. Waters (certificates Nos. 11 and 12).

June 10, received a bill for $500 from G. E. Alexander for legal services in connection with organization of the company and issued certificate No. 13 for 5 shares in payment.

June 15, H. M. Williams subscribed for 50 shares of stock and paid 50% on account. (No entry in Stockholders Ledger.) R. L. Mannix sold 15 shares each to W. D. Thompson, J. T. Waters, and R. W. Davis (certificates Nos. 14, 15, 16 and 17). J. K. Cooper sold 20 shares to F. C. Andrews (certificate No. 18).

June 25, H. M. Williams paid 25% on account of his subscription. K. D. Browne sold 75 shares to H. S. Green (certificates Nos. 19 and 20).

Required:

(*a*) Journal entries to record above transactions.

(*b*) Trial balance of accounts used in (*a*).

(*c*) Stockholders Ledger designed and written up for all stockholders. Use form outlined on page 251.

(*d*) List of stockholders, with number of shares and par value of stock held by each.

EXERCISE 29-d

The following transfers of stock took place on the books of the Ames Corporation during the month of October, 1926.

October 1. Five shares from H. J. Gammons to S. F. Nesbitt. Original certificate No. 24, 5 shares; certificate to Nesbitt, No. 32.

10 One hundred shares from M. W. Wilson to R. M. Lane. Original certificate No. 21, 100 shares; certificate to Lane, No. 42.

15 Ten shares from L. D. O'Neil to E. G. Pitts. Original certificate No. 10, 25 shares; reissued to O'Neil, No. 33; issued to Pitts, No. 34.

25 Fifty shares from F. C. Atwood to J. W. Bonnar. Original certificate No. 5, 100 shares; reissued to Atwood, No. 36; certificates to Bonnar, Nos. 37 to 41, 10 shares each.

30 Fifteen shares from F. A. McGrath to A. A. Wood. Original certificates Nos. 15, 16 and 17, 5 shares each; certificate to Wood, No. 35.

Required:

Entries for the above items as they would appear in the Stock Transfer Book of the Ames Corporation. Design the form of Stock Transfer Book prescribed by the New York State Comptroller, shown on page 251.

EXERCISE 29-e

Design the form of Stock Transfer Book illustrated on page 251 and record therein the stock transfer items appearing in Exercise 29-c, pages 253–254.

QUESTIONS FOR DISCUSSION

1. Is there a system of bookkeeping peculiar to corporations? Explain.
2. How does the General Ledger of a corporation differ from that of a partnership in the same line of business?
3. What is meant by the "corporate records"? Name them.
4. What determines the number and type of the corporate records to be used?
5. Which of the corporate records are necessary in all corporations?
6. In what book is recorded the authority for issuing stock, for declaration of dividends, and for authorization of bond issues?
7. Who keeps the Minute Book? Does the bookkeeper make entries in this book?
8. Where should the corporation charter and by-laws be filed?
9. Assume that A, B and C are interested in forming a corporation. How should they proceed with the organization if they wish to sell stock to their friends?
10. How does the Subscription Book differ from the Subscription Ledger?
11. When is it necessary to use the Subscription Ledger?
12. What is the purpose of a stock certificate?
13. State how shares of stock are transferred from one stockholder to another.
14. Why should the stub of the Stock Certificate Book be carefully filled out?
15. How are canceled stock certificates disposed of?
16. What is the relation of the Stockholders Ledger to the General Ledger?
17. How is the Stock Transfer Book used?
18. What are the duties of transfer agents?
19. How is the Dividend Book used and what information does it contain?
20. Explain which of the corporate records are subsidiary to accounts in the General Ledger.

CHAPTER XXX

PROPRIETORSHIP CHANGED TO A CORPORATION

Capital Stock Issued for Assets Other Than Cash. — A corporation may issue stock in exchange for various kinds of assets other than cash. The business corporation law in some instances provides that "Capital Stock may be issued for cash; property, tangible or intangible; services or expenses." Practically anything of value may be purchased and paid for in stock, such as land, buildings, merchandise, shares of stock and bonds of other corporations, patent rights, and even services and expenses. Some states do not permit the issue of stock for notes but it may be issued for goodwill. The Board of Directors decide what value shall be placed upon property thus taken over in exchange for capital stock.

If the property is being offered in payment of regular subscriptions to capital stock, the entry is similar to that made when a customer turns over property in payment of an account, the property being debited instead of cash. For instance, James Whalen having subscribed for $10,000 of capital stock, and the directors having agreed to accept machinery and equipment in payment for the same, the entry in the journal is as follows:

Machinery and Equipment	$10,000.00	
Subscriptions Receivable		$10,000.00
Machinery received from James Whalen in full payment for his stock subscription.		

The stock certificate is then issued in the usual manner and recorded as previously explained.

However, when a corporation already established in business takes over sundry assets of this kind, it is usually considered the same as a regular purchase and the subscription account is omitted. For instance, George Holland has a small factory building equipped with machinery which he agrees to sell to a corporation together with certain patent rights that he owns. Assuming that the land is valued at $15,000, the building at $50,000, the machinery at $10,000, and the patent rights at $5,000, the entries in the General Journal are as follows:

Land	$15,000.00	
Buildings	50,000.00	
Machinery	10,000.00	
Patent Rights	5,000.00	
George Holland, Vendor		$80,000.00
To record assets acquired from George Holland to be paid for in capital stock of the corporation.		
George Holland, Vendor	80,000.00	
Capital Stock (or Unissued Stock)		80,000.00
Capital stock issued in settlement for assets acquired from him.		

Incorporation of a Single Proprietorship. — When an individual decides to incorporate his business, it is necessary for him to associate himself with at least two others who with him become the incorporators of the proposed corporation. The various legal steps must be complied with as explained in previous chapters. Such a transaction is treated as a sale of the business by the individual to the corporation and is recorded as such. The entries to be made will depend upon whether new books are to be used by the corporation or whether the old books are to be continued. When a going business is incorporated the element of goodwill usually has to be considered. The nature of goodwill and the method of recording it were explained in Chapter XXI.

When a new set of books is to be used by the corporation, the entries to open the books are made in the following order:

1. The usual entry to record the capital stock authorized by the charter. (This entry may be omitted when all the stock is issued at the time of organization.)
2. Debit each of the assets (including goodwill) acquired from the previous owner of the business and credit the owner's Vendor account for the total.
3. Debit the vendor for the sum of the liabilities assumed by the corporation and credit each liability account.
4. Debit the vendor for the capital stock issued to him and credit Capital Stock account. If cash or bonds are given in payment, they will be credited instead of Capital Stock.

Illustration

Ames, Bacon and Hall form a corporation, known as the Hall Mfg. Co., with an authorized capital stock of $100,000 for the purpose of operating the business owned by Hall, whose balance sheet is as follows:

H. E. Hall

Balance Sheet, June 30, 19—

Assets		Liabilities	
Plant and Equipment	$35,000.00	Mortgage Payable	$12,000.00
Inventory	10,000.00	Accounts Payable	3,000.00
Accounts Receivable	5,000.00	H. E. Hall, Capital	37,000.00
Patent Rights	2,000.00		
	$52,000.00		$52,000.00

Hall's business is taken over at a valuation of $50,000 and capital stock for that amount is issued to him. Ames and Bacon subscribe for the balance of the capital stock, pay cash for it, and receive their stock certificates.

Opening the New Set of Books. — Entries to open corporation books are:

Plant and Equipment	$35,000.00	
Inventory	10,000.00	
Accounts Receivable	5,000.00	
Patent Rights	2,000.00	
Goodwill	13,000.00	
H. E. Hall, Vendor		$65,000.00
To record assets acquired from Mr. Hall.		
H. E. Hall, Vendor	15,000.00	
Mortgage Payable		12,000.00
Accounts Payable		3,000.00
To record liabilities assumed for Mr. Hall.		
H. E. Hall, Vendor	50,000.00	
Capital Stock		50,000.00
To record issue of stock to settle vendor's account.		
Cash	50,000.00	
Capital Stock		50,000.00
To record sale and issue of stock to Ames and Bacon.		

Closing the Old Books. — The procedure for closing the old books of a single proprietorship is the same as that for a partnership as outlined in Chapter XXIII. Since Mr. Hall turns over to the corporation net assets valued at $37,000 and receives in payment therefor capital stock valued at $50,000, the difference, or $13,000, represents goodwill which is brought onto the books and credited to Mr. Hall's capital account. The entries to close the books follow:

Goodwill	$13,000.00	
H. E. Hall, Capital		$13,000.00
To credit proprietor's account with goodwill arising from sale of business to corporation.		
Hall Mfg. Co., Vendee	52,000.00	
Plant and Equipment		35,000.00
Inventory		10,000.00
Accounts Receivable		5,000.00
Patent Rights		2,000.00
To record transfer of assets to corporation.		
Mortgage Payable	12,000.00	
Accounts Payable	3,000.00	
Hall Mfg. Co., Vendee		15,000.00
To credit corporation with liabilities assumed by them.		
Capital Stock of Hall Mfg. Co.	50,000.00	
Hall Mfg. Co., Vendee		50,000.00
To credit the corporation with stock received in payment for net assets of the business.		
H. E. Hall, Capital	50,000.00	
Capital Stock of Hall Mfg. Co.		50,000.00
To record stock turned over to Mr. Hall to close his capital account.		

Entries when Old Books are Continued. — Assuming that the books now in use are to be continued, the entries to adjust the accounts are as follows:

Goodwill	$13,000.00	
H. E. Hall, Capital		$13,000.00
To credit proprietor's account with goodwill arising from sale of business to corporation.		
H. E. Hall, Capital	50,000.00	
Capital Stock		50,000.00
To record issue of stock to Mr. Hall and the transfer of his interest to the corporation.		
Cash	50,000.00	
Capital Stock		50,000.00
To record sale and issue of stock to Ames and Bacon.		

The balance sheet of the business after incorporation, whether the same or new books are used, is as follows:

Hall Mfg. Co.

Balance Sheet, June 30, 19—

Assets		Liabilities	
Plant and Equipment	$ 35,000.00	Mortgage Payable	$ 12,000.00
Inventory	10,000.00	Accounts Payable	3,000.00
Accounts Receivable	5,000.00	Capital Stock	100,000.00
Cash	50,000.00		
Patent Rights	2,000.00		
Goodwill	13,000.00		
	$115,000.00		$115,000.00

EXERCISE 30-a

A. B. Carpenter who operates a small dry goods business has sundry assets amounting to $60,000 and sundry liabilities of $5,000. He decides to incorporate June 1, 19— as the Excelsior Dry Goods Co. with a capital stock of $100,000. He arranges with some business associates for a sale of $30,000 of the stock at par; the balance of the stock he takes for his interest in the business.

Required:

(*a*) Entries to open a new set of books for the corporation.

(*b*) Entries to close the books of Mr. Carpenter.

(*c*) Assuming that the old books are to be continued, make journal entries to change them to a corporate basis.

(*d*) Balance sheet of the corporation.

EXERCISE 30-b

Charles Downey who is in the electrical supply business needs more capital and, therefore, decides to incorporate his business as the Downey Electric Company. His balance sheet on January 1, 19— is as follows:

Assets		Liabilities	
Cash	$ 850.00	Accounts Payable	$ 1,000.00
Inventory	5,200.00	Notes Payable	2,000.00
Accounts Receivable	1,540.00	Charles Downey, Capital	8,000.00
Notes Receivable	2,410.00	Charles Downey, Personal	500.00
Store Fixtures	1,500.00		
	$11,500.00		$11,500.00

The corporation is to have a capital stock of $25,000 of which Downey is to receive $15,000 for his interest in the business. Thomas Williams and Charles French each subscribe for 50 shares of the stock and pay cash for the same. Downey turns over all his assets, including cash, and the corporation assumes his liabilities and issues to him 150 shares of stock. A new set of books is to be used.

Required:

(*a*) Journal entries to close Downey's books.

(*b*) Journal entries to open the books of the corporation.

(*c*) Balance sheet of the corporation after the transfer of the business.

EXERCISE 30-c

The Fenway Specialty Co. was incorporated on June 30, 19— with an authorized capital stock of $200,000 consisting of 2,000 shares of a par value of $100 each. Capital stock was disposed of as follows:

100 shares were subscribed and paid for in cash by the incorporators.

200 shares were issued in payment for plant and equipment.

5 shares were issued to a lawyer as compensation for services in securing the charter of the company.

50 shares were issued for sundry patent rights.

1,000 shares were subscribed at par and 50% paid in cash, the balance to be paid in two months.

Required:

(*a*) Journal entries to record the above data.

(*b*) Balance sheet of the corporation after recording the above items.

EXERCISE 30-d

The Touraine Mfg. Co. was organized under the laws of the state of Ohio on January 1, 19— with an authorized capital stock of $150,000 divided into 1,500 shares of a par value of $100 each. $100,000 of the stock was subscribed as follows: A. B. Turner, 750 shares; Wallace Smith, 100 shares; Charles Atwood, 50 shares; George Doane, 100 shares. Turner paid $5,000 in cash and the other subscribers 50% of their subscriptions in cash. On January 15 the corporation bought Turner's business, agreeing to pay him $70,000. He turned over to the corporation assets as follows: Plant, $60,000; machinery, $10,000; delivery equipment, $4,500; accounts receivable, $4,000; stock of goods, $18,500; notes receivable, $2,000. The corporation assumed his liabilities as follows: Mortgage payable, $20,000; accounts payable, $8,500; bank loan, $5,000. The balance of his subscription is canceled and 750 shares of stock are issued to him.

Required:

(*a*) Journal entries to open corporation books and record the above items.

(*b*) Balance sheet of the corporation.

EXERCISE 30-e

The Lake Mfg. Co. is organized with a capital stock of $150,000, par value of shares $100, to purchase a business formerly conducted by A. C. Lake. The business shows total sundry assets amounting to $175,000 and total sundry liabilities amounting to $85,000. Charles King, Oliver Jordan, and Thomas Kane each purchase 50

shares of stock at par for cash, and become directors of the corporation. 50 shares of stock are issued for sundry expenses of organization. 250 shares are issued to a patentee for certain patent rights. All of the remaining stock is issued to Lake in payment for the net assets of his business. Lake immediately donates $20,000 of stock to the corporation to be used to procure additional working capital. This stock is sold one month later at $85 per share.

Required:

(*a*) Journal entries to record all of the above data.

(*b*) Balance sheet of the corporation.

QUESTIONS FOR DISCUSSION

1. A lawyer presents a bill for legal services amounting to $500 in connection with the organization of a corporation and agrees to accept five shares of stock, par value $100, in payment. May the corporation issue stock for this purpose?

2. When property other than cash is received in payment for stock subscriptions, who determines what value to place on such property?

3. When a corporation already established in business buys property to be paid for in capital stock, how is the purchase recorded?

4. For what purpose does the individual owner of a business desire to incorporate his business?

5. Why is the element "goodwill" so often present when a "going" business is incorporated?

6. Explain why it is preferable to open a new set of books when a corporation is formed to operate a business that has been in existence for some time.

7. When a going business is incorporated, does any change take place in the method of conducting the business?

8. What becomes of the cash on hand when a business is incorporated?

9. In what particular does the balance sheet of a business differ after incorporation from what it was under a single proprietorship?

10. What is a Vendor account? Outline the entries that you would expect to find in this account and state whether they are debit or credit entries.

11. What expenses would be necessary in incorporating a single proprietorship business?

CHAPTER XXXI

PARTNERSHIP CHANGED TO A CORPORATION

Legal Procedure Necessary. — The procedure for changing a partnership to a corporation is much the same as that required to incorporate a single proprietorship explained in Chapter XXX. The transaction is regarded as a sale of the partners' interests in the business to the corporation. The first step to be taken is to see that the legal requirements relative to dissolution of the firm are complied with. This is often simplified by a provision in the articles of copartnership of the firm relative to dissolution. The next step is to draw up the proper papers and secure a charter from the state. The partners subscribe to the stock of the corporation, usually in the proportion that their capital accounts bear to each other. The corporation then agrees to buy the business from the firm and apply the purchase price against their stock subscriptions.

Adjustment of Accounts at Time of Sale. — It is sometimes agreed that the assets of the partners are to be transferred to the corporation at a valuation different from that shown in the firm books. The figures on the books must then be brought into agreement with the sale figures. Any profit or loss from these adjustments is carried to the partners' capital accounts in the ratio in which they share profits and losses. These adjustments appear in the partnership books only, the assets and liabilities being recorded in the corporation books at the sale value. The process of closing partnership books was explained in Chapter XXIII.

Entries to Open Corporation Books. — The opening entries for a corporation taking over a partnership are made in the same order as those for the incorporation of a single proprietorship outlined on page 257. An account is opened with the partnership, which is known as the vendor or seller. Accounts with the individual partners do not appear in the General Ledger of the corporation. It is not necessary to use a Subscription account in the ledger as it would be closed out immediately. If the partnership books are to be continued by the corporation, practically the only change made in the accounts is to close out the partners' capital accounts and substitute for them the capital stock accounts.

Illustration

The Ames Mfg. Co. is formed with an authorized capital stock of $100,000 for the purpose of purchasing and operating the business of two small firms. One of these is owned by Robert Hale and Aaron Hood whose balance sheet follows:

Hale and Hood

Balance Sheet, January 1, 19—

Assets		Liabilities	
Cash	$ 9,000.00	Notes Payable	$10,000.00
Land and Buildings	40,000.00	Robert Hale, Capital	50,000.00
Equipment	20,000.00	Aaron Hood, Capital	25,000.00
Other assets	16,000.00		
	$85,000.00		$85,000.00

It is agreed that Hale and Hood shall retain their cash; that the land and buildings shall be valued at $50,000, the equipment at $15,000, and goodwill at $12,000; and that payment shall be made in capital stock of the corporation. Profits are shared equally. The journal entries to adjust the accounts, close partnership books, and open corporation books, when a new set of books is to be used, are as follows:

Entries to Adjust the Partnership Accounts. —

Land and Buildings	$10,000.00	
Robert Hale, Capital		$ 5,000.00
Aaron Hood, Capital		5,000.00
To credit partners with profit due to appraisal of land and buildings.		
Robert Hale, Capital	2,500.00	
Aaron Hood, Capital	2,500.00	
Equipment		5,000.00
To charge partners with loss due to appraisal of equipment.		
Goodwill	12,000.00	
Robert Hale, Capital		6,000.00
Aaron Hood, Capital		6,000.00
To set up goodwill agreed upon and credit same to partners' capital accounts.		

Entries to Close the Partnership Books. —

Ames Mfg. Co., Vendee	$93,000.00	
Land and Buildings		$50,000.00

Equipment		15,000.00
Goodwill		12,000.00
Other assets		16,000.00
To record transfer of assets to the corporation.		
Notes Payable	10,000.00	
Ames Mfg. Co., Vendee		10,000.00
To credit corporation with liabilities assumed.		
Capital Stock of Ames Mfg. Co.	83,000.00	
Ames Mfg. Co., Vendee		83,000.00
To credit corporation with stock received for net assets of the firm.		
Robert Hale, Capital	58,500.00	
Aaron Hood, Capital	33,500.00	
Cash		9,000.00
Capital Stock of Ames Mfg. Co.		83,000.00
To record distribution of cash and stock to partners to close capital accounts.		

Entries to Open the Corporation Books. —

Capital Stock Unissued	$100,000.00	
Capital Stock Authorized		$100,000.00
To record authorized capital stock as shown by charter.		
Land and Buildings	50,000.00	
Equipment	15,000.00	
Goodwill	12,000.00	
Other assets	16,000.00	
Hale and Hood, Vendors		93,000.00
To record assets acquired from Hale and Hood.		
Hale and Hood, Vendors	10,000.00	
Notes Payable		10,000.00
To record liability of the firm assumed by the corporation.		
Hale and Hood, Vendors	83,000.00	
Capital Stock Unissued		83,000.00
To record issue of capital stock to partners in payment for their interest in the firm.		

Entries to Change Books to Corporate Basis — assuming that the partnership books are to be continued by the corporation. — The adjustment entries are made on the firm books the same as shown on page 264, after which are inserted the following entries:

Capital Stock Unissued	$100,000.00	
Capital Stock Authorized		$100,000.00
To record authorized capital stock as shown by charter.		
Robert Hale, Capital	58,500.00	
Aaron Hood, Capital	33,500.00	
Capital Stock Unissued		83,000.00
Cash		9,000.00
To record issue of stock and distribution of cash to partners to close out capital accounts.		

The balance sheet of the corporation after taking over the business of Hale and Hood, whether the same or new books are used, is as follows:

Balance Sheet, January 1, 19—

Assets		Liabilities		
Land and Buildings	$50,000.00	Notes Payable		$ 10,000.00
Equipment	15,000.00	Capital Stock:		
Goodwill	12,000.00	Authorized	$100,000.00	
Other assets	16,000.00	Less – Unissued	17,000.00	
		Issued		83,000.00
	$93,000.00			$ 93,000.00

EXERCISE 31-a

Corporation X is formed January 1, 19 – with an authorized capital of $200,000 divided into 1,000 shares of preferred stock and 1,000 shares of common stock, par value of each $100. The corporation takes over the business of Hoffman and Collins. At the time of transfer the books of the partnership show the following:

Assets		Liabilities	
Cash	$ 2,500.00	Accounts Payable	$ 12,530.63
Accounts Receivable	5,360.43	Notes Payable	8,500.00
Notes Receivable	3,640.00	Mortgage Payable	30,000.00
Goods on Hand	24,530.20	W. B. Hoffman, Capital	35,000.00
Plant and Equipment	75,000.00	A. B. Collins, Capital	25,000.00
	$111,030.63		$111,030.63

The values as shown by the balance sheet are accepted by the corporation which takes over all the assets, except cash, and assumes all the liabilities. The goodwill value is agreed upon at $25,000. The corporation issues $50,000 preferred stock as part of the purchase price and common stock for the balance. 150 shares of common stock are issued to T. Robinson for delivery equipment. 200 shares of common stock and 250 shares of preferred stock are sold at par for cash and the certificates issued.
Required:

(*a*) Necessary journal entries to open the corporation books and record the subsequent transactions.

(*b*) Ledger accounts after posting the entries in (*a*).

(*c*) Balance sheet after incorporation.

EXERCISE 31-b

On July 1, 19— the books of Bergman and Engstrom, partners who wish to incorporate their business, show the following:

Assets		Liabilities	
Cash	$24,775.50	Accounts Payable	$12,485.13
Accounts Receivable	19,540.38	Notes Payable	26,740.50
Notes Receivable	9,000.00	R. A. Engstrom, Capital	40,000.00
Merchandise on Hand	38,409.75	P. H. Bergman, Capital	20,000.00
Equipment	7,500.00		
	$99,225.63		$99,225.63

The corporation, known as the Bergman Mfg. Co., is formed with an authorized capital stock of $300,000 consisting of 1,000 shares preferred stock and 2,000 shares common stock, par value $100. The goodwill of the partners is valued at $30,000. Profits and losses are shared in proportion to capital investments. The corporation takes over all the assets and assumes all the liabilities of the firm. The partners receive in settlement $50,000 preferred stock and $40,000 common stock. 200 shares of preferred stock are sold to outsiders at par for cash and certificates issued.
Required:

(*a*) Necessary entries to close partnership books.

(*b*) Necessary entries to open corporation books and to record subsequent transactions as outlined above.

EXERCISE 31-c

Sawyer and Hayes, partners in an electrical business, desiring to expand their business but not wishing to assume any additional personal risk, decide to incorporate their business. The new corporation is incorporated with an authorized capital of $75,000 divided into 1,500 shares of $50 each, to be known as the Sawyer Electrical Supply Co. The balance sheet of the firm at the time of incorporation is as follows:

Balance Sheet, July 1, 19—

Assets		Liabilities	
Cash	$ 5,680.24	Accounts Payable	$17,931.07
Accounts Receivable	8,974.60	Notes Payable	7,650.50
Notes Receivable	3,000.00	Mortgage Payable	18,000.00
Store Building	20,000.00	N. J. Sawyer, Capital	20,500.00
Store Equipment	6,750.00	E. J. Hayes, Capital	14,500.00
Delivery Equipment	4,300.00		
Merchandise Inventory	29,876.73		
	$78,581.57		$78,581.57

The corporation takes over all the assets and assumes all the liabilities of the partnership at the book valuation, with the following exceptions:

(*a*) Inventory is to be reduced to $26,000.

(*b*) Store building is appraised at $22,500 and is to be valued at that figure.

(*c*) Store equipment is to be reduced to $5,000.

The partners are to receive 1,000 shares of the new corporation stock as compensation for their interest in the firm. The difference between the net assets, after making adjustments, and the amount of stock issued to the partners is to be treated as goodwill. 200 shares of stock are sold for cash and the certificates issued. The balance of the stock is subscribed, payment to be made in 60 days.

Required:

(*a*) Entries to close partnership books. Profits and losses are shared equally.

(*b*) Open ledger accounts (five to page), insert balances shown in the firm's balance sheet, post entries in (*a*) and rule accounts.

(*c*) Necessary entries to open corporation books and record above transactions.

(*d*) Balance sheet of corporation.

EXERCISE 31-d

The firm of Holmes and Weeks decide to incorporate on September 1, 19— under the name of The Holmes-Weeks Co. with an authorized capital stock of $25,000. Previous to the incorporation the following balance sheet has been approved:

Assets		Liabilities	
Cash	$ 5,823.52	Accounts Payable	$ 5,766.50
Accounts Receivable	4,712.90	Notes Payable	1,499.50
Goods on Hand	9,689.58	Mortgage Payable	10,000.00
Furniture and Fixtures	700.00	B. Holmes, Capital	9,000.00
Delivery Equipment	2,250.00	D. Weeks, Capital	9,000.00
Real Estate	12,000.00		
Insurance Prepaid	90.00		
	$35,266.00		$35,266.00

It is further agreed between the partners that the following reserves are to be created:

For depreciation on building ($9,000), 2% per annum for three years.

For bad debts, $300.

For delivery equipment depreciation, 25% per annum for one year.

The partners retain the cash and take $20,000 capital stock for their interest in the partnership. $5,000 capital stock is sold for cash.

Required:

(*a*) Entries to close partnership accounts and open corporate accounts, assuming that the same set of books is to be used by the corporation.

(*b*) Open ledger accounts for above items, insert balances as shown by the balance sheet, and post entries in (*a*).

(*c*) Balance sheet of The Holmes-Weeks Co.

EXERCISE 31-e

On January 1, 19— Frank Higgins and George Daly formed a partnership under the name of Higgins & Co., each investing $10,000 in cash. The partners purchased for cash the dry goods business of Fred Watson paying for the same $18,000. The assets acquired from Watson were as follows: Notes Receivable, $2,000; Accounts Receivable, $2,640; Goods on Hand, $8,950; Delivery Equipment, $1,500. The balance of the purchase price is to be considered as Goodwill.

On June 30, 19— it was decided to incorporate as the Hub Dry Goods Co., the incorporators being Higgins, Daly and Watson. The authorized capital of the corporation was $50,000 (par value, $100). The incorporators each subscribed for 50 shares of stock at par and paid for same in cash. The balance sheet of the firm at the time of incorporation was as follows:

Assets		Liabilities	
Cash	$ 7,241.50	Accounts Payable	$ 3,151.60
Accounts Receivable	4,321.70	Notes Payable	5,000.00
Merchandise Inventory	14,678.40	Frank Higgins, Capital	12,500.00
Delivery Equipment	1,500.00	George Daly, Capital	10,000.00
Goodwill	2,910.00		
	$30,651.60		$30,651.60

150 shares were issued to Higgins and 120 shares to Daly in payment for their interest in the business. 60 shares were sold to outsiders for cash. The balance of the stock was subscribed for but payment has not been received.

Required:

(*a*) Entries to open partnership books on January 1.

(*b*) Entries to close partnership books on June 30.

(*c*) Entries to open corporation books and record subsequent transactions.

(*d*) Balance sheet of corporation.

QUESTIONS FOR DISCUSSION

1. In what particular do the closing entries of a partnership differ from those of an individual proprietorship?
2. In what way may the articles of copartnership assist in the dissolution of the firm?
3. What are the legal requirements in order to change from a partnership to a corporation?
4. Outline the bookkeeping procedure necessary to change a set of books to a corporate basis when the same set of books is to be continued by the corporation.
5. What is the purpose of adjusting the accounts at the time a partnership is incorporated? Do these adjustments appear on the corporation books?
6. Do the adjustments referred to in (5) always result in a profit for the partners?
7. When the partners sell out their interests in a partnership, is the cash on hand usually included?
8. Name some of the reasons why a firm might desire to incorporate their business.

SUMMARY OF CHAPTERS XXIX-XXXI

A corporation keeps two sets of records; one for the current business transactions, and the other for the corporate activities, such as sale and transfer of stock, dividend declarations, etc. The most important corporate records are as follows: Minute Book, Stock Certificate Book, and Stockholders Ledger. Stock transfer and stock subscription records are also sometimes used. The Minute Book is an important record as it contains a record of official action taken at the various stockholders' and directors' meetings. The Stockholders Ledger is a subsidiary record containing an account with each stockholder and shows the number of shares of stock owned by him. It is subsidiary to the Capital Stock account in the General Ledger.

In changing the form of legal organization from that of a single proprietorship or partnership to that of a corporation the transaction is recorded as a sale of the business on the books of the owner or firm and as a purchase on the books of the corporation. When sold at more than book value, goodwill is considered to be present and is set up on the books as an asset and credited to the former owners in profit and loss ratio. The old books may be closed and a new set opened or the same books may be continued. When the same books are continued, the former owners' accounts are closed out and the capital stock accounts substituted for them. The other accounts remain the same unless certain of them require adjusting, in which case they are corrected before closing out the old capital accounts.

MANUFACTURING ACCOUNTS

CHAPTER XXXII

FUNCTIONS OF SPECIAL ACCOUNTS REQUIRED

Difference Between Manufacturing and Trading Business Enterprises. — From the operating standpoint business enterprises are divided into two classes known as *manufacturing* and *trading*. The *manufacturer* buys raw materials, places them in his factory equipped with proper machinery and employs labor to work on the material and convert it into a finished product which he sells to the trader or merchant. The *merchant*, or trader, buys the finished goods, places them in stock, and sells them in practically the same condition as that in which they were received. The manufacturer *makes* the finished product and sells it. The trader *buys* the finished product and sells it. The chief difference from the bookkeeping standpoint is the way in which the marketable product is acquired.

The manufacturer of shoes buys leather and other necessary supplies, places them in his plant, and with the aid of machinery and skilled labor converts the leather and supplies into shoes which he sells to the merchant. The merchant dealing in shoes, whether he is a retailer or wholesaler, buys his shoes from the factory, packed in boxes ready to sell.

The trader finds the cost of his product by adding to the invoice price the cost of transportation and any other expenses incurred in placing the goods on his shelves ready for sale. The manufacturer adds to the invoice price of his material not only the cost of placing the same in his factory, but also the cost of operating his machinery, the wages he pays the workmen in the factory, and all other expenses necessary to finish his product and place it in salable condition.

Additional Data Required in a Manufacturing Business. — It is very important that the manufacturer keep a careful record of what it costs him to produce his product; otherwise he may sell at a loss. In a trading business the gross profit is found by deducting from the net sales the cost of goods sold, which is found by adding merchandise inventory at the beginning of the period to net purchases and freight paid on the same during the period, and deducting the inventory on hand at the end of the period.

The manufacturing process is usually divided into three stages: the *Raw Materials* stage, the *Factory* or making stage, usually termed *Work in Process*,

and the *Finished Goods* stage. Accounts are kept to record the costs and expenses in each stage. A *group* of accounts is kept to show the cost of procuring the raw materials, the cost of storing them, and the amount on hand at the close of the period. Other accounts are kept to show the cost of converting the material into finished stock, such as the cost of providing tools, machinery, and labor to run the machines, and various expenses in connection with providing a factory building, power, heat, light, supervisors, etc. At the end of the period a record must be made also of those goods that are only partly finished. In the finished goods stage accounts are provided to show finished goods available for sale and the cost of those goods sold.

In a trading business, expenses are usually classified under two general groups — *Selling* and *General Administrative*. In a manufacturing business both of these groups are used and a third group, known as *Factory Expenses*, is added.

It is also necessary to have a new group of fixed asset accounts which includes such items as *Machinery and Equipment*, *Patterns and Drawings*, *Small Tools*, *Patent Rights*, etc.

Elements of Manufacturing Cost. — The elements of cost necessary to bring raw materials into a finished or salable condition are usually divided into three groups: (1) the cost of raw materials, (2) the cost of labor, and (3) the cost of factory expenses. At least one account is kept for each of these elements.

Raw Materials. — This refers to that material which is in its natural state, or nearly so, and must pass through various operations changing its form or texture in order to become finished or salable. In converting some material such as sheet metal, tin or logs to finished goods only the form is changed. In other material such as pig iron, copper, etc., both the form and texture are changed. It is possible for finished goods in one department or factory to become the raw material for another department or factory. Thus, pig iron becomes the raw material for the steel manufacturer and steel becomes the raw material for the manufacturer of tools, etc.

Labor. — This refers to the cost of services rendered in converting the material into the finished product. The labor may be hand work, by means of tools or by the operations of machinery. Labor that is rendered directly upon the material is known as *direct* labor; while labor of an incidental nature that cannot be applied directly to any particular portion of the material is known as *indirect* labor. Thus, the labor of a man using tools or operating a machine is direct labor while that of a foreman or a watchman is indirect labor.

Factory Expenses. — Any expenses incurred that would not be necessary if the business were a trading concern are known as *factory expenses*. Other

names for such expenses are "manufacturing expenses," " burden," " overhead," etc. These expenses include the cost of superintendence of the factory; wages of foremen, timekeepers, storekeepers, and cost clerks; supplies, rent, fuel, power, light, taxes, insurance, repairs and depreciation of factory building, repairs and depreciation of machinery, etc.

The cost of *raw materials* plus the cost of *direct labor* is known as *prime cost.* *Prime cost* plus the cost of *factory expenses* is known as *factory cost.* *Factory cost* plus *selling and general administrative expenses* is known as *total cost.* Total cost plus profit gives the selling price. These components may be shown by means of a diagram as follows:

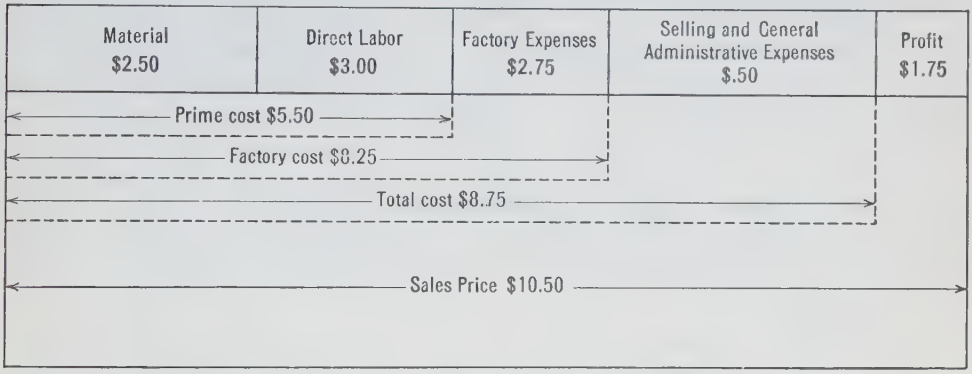


Illustration — Components of Manufacturing Cost

Functions of Ledger Accounts Peculiar to Manufacturing Concerns. — Accounts are kept in the General Ledger with each of the cost elements — *raw materials*, *direct labor*, and *factory expenses.*

Raw Materials Account. — This account is used to record the cost of materials purchased for the factory which enter into the finished product. The cost includes the invoice price of the goods and the cost of transportation to the factory. The expenses incurred in connection with purchasing and storing raw materials until needed in the factory are theoretically a part of the cost of raw materials and may be charged to that account. However, because of the difficulty in determining the proportion of this expense which should be added to the physical inventory at the end of the fiscal period, it is usually charged to Factory Expenses account. Invoices received should be verified as to kind, quality, quantity ordered, and price before being recorded in this account. The debits and credits to the account may be stated as shown on the following page.

RAW MATERIALS

Debit:	*Credit:*
At beginning of fiscal period: With inventory of raw materials on hand, if any. During the fiscal period: With the cost of raw materials purchased. With the cost of freight and cartage on material purchased (unless a separate Freight In account is kept).	During the fiscal period: With the cost of materials returned to seller. With any adjustments that reduce the cost of materials purchased. At close of fiscal period: With the cost of raw materials used during the period, which is found by deducting from the cost of the materials purchased, as shown by this account, the cost of materials on hand as shown by a physical inventory.

The balance of the account after closing represents the cost of raw materials on hand and appears in the balance sheet under Current Assets. The cost of raw materials used appears in the manufacturing statement as one of the costs of goods manufactured.

Direct Labor Account. — This account is used to record the part of the payroll that represents wages of men engaged in working directly on the product.

DIRECT LABOR

Debit:	*Credit:*
With cost of direct labor as shown by the payroll.	With any adjustments reducing the cost of direct labor.

The balance of the account represents the cost of labor directly related to the cost of the product. At the end of the fiscal period it is closed into the Work in Process account and appears in the manufacturing statement as one of the costs of goods manufactured.

Factory Expenses Account. — This account is used to record all expenses incurred in connection with manufacturing the product except those charged to Raw Materials and Direct Labor. These expenses are so varied that several accounts are usually employed to record the various items. They represent one of the three primary elements of the cost of the product and should receive very careful attention.

FACTORY EXPENSES

Debit:	*Credit:*
With indirect labor as shown by the payroll. With rent or maintenance of the factory. With power, heat and light. With repairs to machinery and equipment. With depreciation of machinery and equipment. With insurance and taxes on machinery and equipment. With factory supplies used. With cost of tools, patterns and patents written off.	With any adjustments that reduce the cost of factory expenses such as subletting factory space, sale of power, etc.

The balance of this account represents the total factory expenses for the period and is closed into Work in Process account. It is one of the costs of goods manufactured and appears as such in the manufacturing statement.

Work in Process Account. — This is a summary account to which is transferred the cost of material, labor and factory expenses for the fiscal period as shown by the preceding three accounts. This account represents the factory or manufacturing process and is charged with all factory costs. At the close

WORK IN PROCESS

Debit:	*Credit:*
At close of fiscal period: With any work in process of manufacture at the beginning of the period. With the cost of raw material used transferred from the Raw Materials account. With the cost of direct labor applied to the product transferred from the Direct Labor account. With the cost of factory expenses for the period transferred from the Factory Expense account.	At close of fiscal period: With the cost of finished goods manufactured during the period, which is found by taking an inventory of work in process and deducting same from the total debit side of this account.

of the period the inventory of work in process is deducted from the total cost and the remainder represents the cost of goods finished during the period, which is transferred to the Finished Goods account. The balance after closing represents the cost of goods in the process of manufacture and appears in the balance sheet under Current Assets.

Finished Goods Account. — This account takes the place of the Purchases account in a trading concern. It is charged with salable goods manufactured or purchased and credited with cost of sales, which is found by taking a physical inventory and deducting the same from the total debits to this account.

FINISHED GOODS

Debit:	*Credit:*
At beginning of fiscal period: With any salable goods on hand. At close of fiscal period: With the cost of finished goods manufactured during the period transferred from Work in Process account.	During the fiscal period: With any adjustments that reduce the cost of finished goods. At close of fiscal period: With the cost of goods sold which is transferred to Sales account.

The balance of this account represents the cost of finished goods in stock and is an asset. It is shown in the balance sheet as a Current Asset.

Other Factory Accounts. — Accounts are kept with the Factory Building, if not rented, and with Machinery and Equipment. These accounts are handled the same as other fixed assets explained in Chapter VI. The repairs, upkeep, and depreciation of these assets are factory expenses.

Accounts may also be kept with Tools and with Factory Supplies. These accounts are charged with the cost of such items purchased during the period. At the close of the period the difference between a physical inventory and the cost is credited to these accounts and charged to Factory Expenses. The balances of these accounts are shown in the balance sheet as current assets.

When accounts are kept with Patent Rights, Trade Marks, Patterns, etc., they are charged with the costs of such items and are then written down over the life of the asset. The portion written off is treated as a factory expense.

Payroll Account. — The method of handling the payroll differs according to the size and organization of the factory. In a small plant only one payroll account is used and to it are charged all salaries and wages as paid. At the close of the fiscal period this account is analyzed and distributed to the proper accounts. The debits and credits to this account may be stated as follows:

PAYROLL

Debit:	*Credit:*
During the fiscal period:	At close of fiscal period:
With all wages and salaries paid as per voucher register.	With direct labor transferred to Direct Labor account.
	With indirect labor transferred to Factory Expenses account.
	With salaries of sales force transferred to Selling Expenses.
	With salaries of general office force transferred to General Administrative Expenses.

The balance of this account, if any, represents the amount of salaries and wages earned but not paid and is a current liability appearing in the balance sheet.

Diagram Illustrating Relation of Manufacturing Accounts. — The following diagram shows the relation of the various manufacturing accounts to each other:

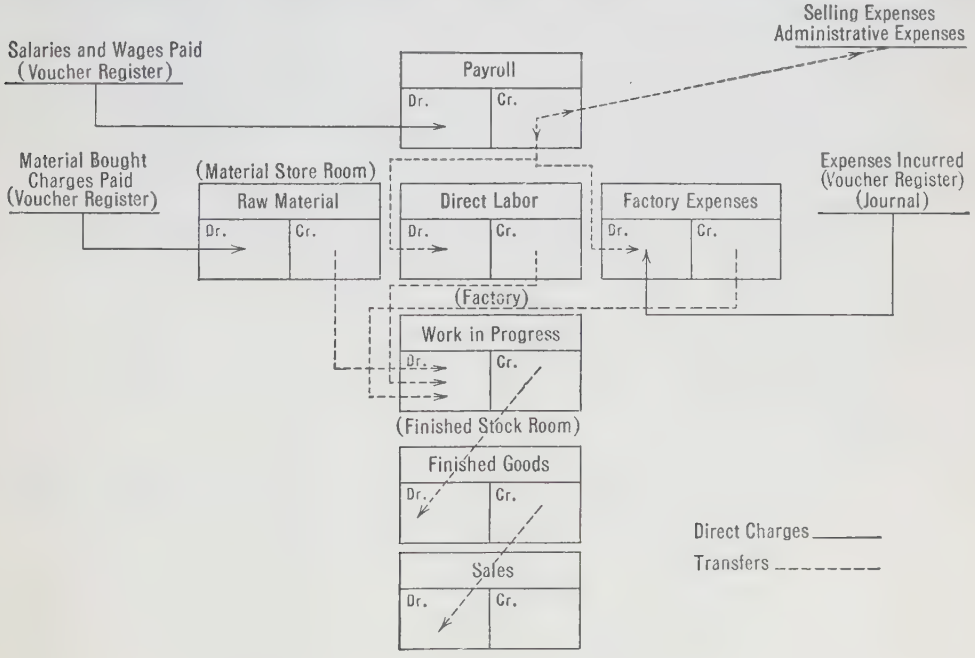


Illustration — Relation of Manufacturing Accounts

Illustration

The following problem is presented to illustrate the use of the accounts described in this chapter. All items other than those affecting the production of goods are condensed as much as possible in order to save space. Plant and equipment are shown in one account contrary to the usual practice, and expenses are summarized in three expense accounts; Factory, Selling and General Administrative.

The Ajax Manufacturing Company
Trial Balance, December 31, 1926

Cash	$ 12,000.00	
Accounts Receivable	14,000.00	
Raw Materials	24,500.00	
Work in Process	12,500.00	
Finished Goods	27,250.00	
Plant and Equipment	125,000.00	
Reserve for Depreciation		$ 18,000.00
Accounts Payable		16,000.00
Capital Stock		150,000.00
Surplus		31,250.00
	$215,250.00	$215,250.00

During the year the following summary of transactions occurred:

(1) Purchases on account: Raw materials, $148,500; supplies, $5,000.
(2) Salaries and wages paid during the year, $273,000.
(3) Expenses paid as follows: Repairs to plant and equipment, $3,250; general factory expenses, $15,410; selling expenses, $2,150; administrative expenses, $3,250.
(4) Sales of merchandise on account, $462,000.
(5) Cash received from customers, $431,000.
(6) Cash paid creditors, $130,000.

Adjustments:

(7) Reserve for depreciation increased $20,000.
(8) Analysis of payroll shows the following: Direct labor, $246,800; indirect labor, $15,200; office salaries, $4,500; salesmen's salaries, $6,500.
(9) Factory supplies on hand as per inventory, $1,000.

Inventories:

Raw Materials	$72,000
Work in Process	24,500
Finished Goods	38,600

Solution

Journal entries for current transactions:

(1) When raw materials and supplies are purchased:		
Raw Materials	$148,500.00	
Factory Supplies	5,000.00	
Accounts Payable		$153,500.00
(2) When salaries and wages are paid:		
Payroll	273,000.00	
Cash		273,000.00
(3) When expenses are paid:		
Factory Expenses (Repairs)	3,250.00	
Factory Expenses (Sundries)	15,410.00	
Selling Expenses (Sundries)	2,150.00	
General Administrative Expenses (Sundries)	3,250.00	
Cash		24,060.00
(4) When finished goods are sold:		
Accounts Receivable	462,000.00	
Sales		462,000.00
(5) When cash is received from customers to apply on account:		
Cash	431,000.00	
Accounts Receivable		431,000.00
(6) When cash is paid creditors to apply on account:		
Accounts Payable	130,000.00	
Cash		130,000.00

Journal entries for adjustments:

(7) When provision is made for depreciation on plant and equipment:		
Factory Expenses (Depreciation)	$20,000.00	
Reserve for Depreciation		$20,000.00
(8) When payroll is analyzed and distributed to proper accounts:		
Direct Labor	246,800.00	
Factory Expenses (Indirect labor)	15,200.00	
General Administrative Expenses (Salaries)	4,500.00	
Selling Expenses (Salaries)	6,500.00	
Payroll		273,000.00

(9) When Supplies account is adjusted and the used portion transferred to Factory Expenses account:

Factory Expenses (Supplies)	$4,000.00	
Factory Supplies		$4,000.00

After entering the balances as shown by the opening trial balance and posting the foregoing journal entries, the General Ledger appears as follows:

Cash

1926						1927					
Dec.	31	Balance		12000	00	Dec.	31	Payroll		273000	00
1927							31	Expenses		24060	00
Dec.	31	Accts. Rec.		431000	00		31	Accts. Pay.		130000	00

Accounts Receivable

1926						1927					
Dec.	31	Balance		14000	00	Dec.	31	Cash		431000	00
1927											
Dec.	31	Sales		462000	00						

Raw Materials

1926											
Dec.	31	Inventory		24500	00						
1927											
Dec.	31	Purchases		148500	00						

Work in Process

1926											
Dec.	31	Inventory		12500	00						

Finished Goods

1926											
Dec.	31	Inventory		27250	00						

Factory Supplies

1927						1927					
Dec.	31	Purchases		5000	00	Dec.	31	Used		4000	00

Plant and Equipment

1926											
Dec.	31	Balance		125000	00						

Reserve for Depreciation

					1926				
					Dec.	31	Balance		18000 00
					1927				
					Dec.	31	Cur. Year		20000 00

Accounts Payable

1926					1926				
Dec.	31	Cash		130000 00	Dec.	31	Balance		16000 00
					1927				
					Dec.	31	Purchases		153500 00

Capital Stock

					1926				
					Dec.	31	Balance		150000 00

Surplus

					1926				
					Dec.	31	Balance		31250 00

Payroll

1927					1927				
Dec.	31	Paid		273000 00	Dec.	31	Distributed		273000 00

Direct Labor

1927				
Dec.	31	Payroll		246800 00

Factory Expenses

1927				
Dec.	31	Repairs		3250 00
	31	Sundries		15410 00
	31	Depr.		20000 00
	31	Ind. labor		15200 00
	31	Supplies		4000 00

Selling Expenses

1927				
Dec.	31	Sundries		2150 00
	31	Salaries		6500 00

General Administrative Expenses

1927												
Dec.	31	Sundries			3250	00						
	31	Salaries			4500	00						

Sales

						1927					
						Dec.	31	Accts. Rec.		462000	00

(*c*) The trial balance taken from the above ledger is as follows:

The Ajax Manufacturing Company

Adjusted Trial Balance, December 31, 1927

	Cash	15940	00		
	Accounts Receivable	45000	00		
	Raw Materials	173000	00		
	Work in Process	12500	00		
	Finished Goods	27250	00		
	Factory Supplies	1000	00		
	Plant and Equipment	125000	00		
	Reserve for Depreciation			38000	00
	Accounts Payable			39500	00
	Capital Stock			150000	00
	Surplus			31250	00
	Direct Labor	246800	00		
	Factory Expenses	57860	00		
	Selling Expenses	8650	00		
	General Administrative Expenses	7750	00		
	Sales			462000	00
		720750	00	720750	00

EXERCISE 32-a

The Wilson Mfg. Company

Trial Balance, December 31, 19—

Cash	$ 5,000.00
Accounts Receivable	7,500.00
Raw Materials	9,200.00
Work in Process	1,800.00
Finished Goods	12,000.00
Plant	40,000.00
Machinery	10,000.00

Accounts Payable		$ 4,500.00
Reserve for Depreciation of Plant		5,000.00
Reserve for Depreciation of Machinery		1,000.00
Capital Stock		70,000.00
Surplus		5,000.00
	$85,500.00	$85,500.00

The following is a summary of the transactions for three months:

(1) Purchases on account: Raw materials, $48,000; factory supplies, $1,000.
(2) Salaries and wages paid during the period, $40,000.
(3) Expenses paid: Factory, $2,500; selling, $850; administrative, $1,500.
(4) Sales of finished goods on account, $105,000.
(5) Cash received from customers, $90,000.
(6) Cash paid creditors, $42,500.
(7) Analysis of payroll shows: Direct labor, $28,000; indirect labor, $8,000; salesmen's salaries, $1,200; office salaries, $2,800.
(8) Depreciation on plant, $1,000; machinery, $500.
(9) Factory supplies on hand as per inventory, $400.

Physical inventories taken at close of period:

Raw Materials	$14,500
Work in Process	6,000
Finished Goods	5,250

Required:

(*a*) Open accounts in the ledger and insert balances shown in above trial balance.
(*b*) Prepare journal entries to record the above transactions.
(*c*) Post entries in (*b*) to ledger in (*a*) and prepare a trial balance before closing.

EXERCISE 32-b

The Downey Mfg. Co. was organized on January 1, 19— with a capital stock of $150,000 which was fully subscribed and paid for in cash. Certificates have been issued to all subscribers. Cash is paid for a factory building valued at $50,000 and machinery at $20,000. During the year the following transactions take place:

Raw material purchased for cash, $5,000; on account, $24,652.10.

Cash payments:

Factory wages	$42,435.60
Office salaries	8,650.00
Factory supplies	3,000.00
Machinery repairs	2,120.40
General factory expenses	8,654.30
Selling expenses	4,235.60
Administrative expenses	3,245.00
Sales of finished goods on account	40,432.80

Cash from customers on account $32,620.40
Cash paid creditors 15,620.10
Factory payroll distributed: Direct, $38,540.23; indirect, $ 3,895.37
Depreciation on plant, 5%; on machinery, 10%
Factory supplies used, $2,000
Inventories at close of period:

Raw material	$ 7,171.80
Work in process	$35,730.40
Finished goods	25,243.90

Required:

(*a*) Journalize the above transactions.

(*b*) Open the following ledger accounts and post (*a*): Cash, Accounts Receivable, Raw Materials, Work in Process, Finished Goods, Factory Supplies, Plant, Reserve for Depreciation of Plant, Machinery, Reserve for Depreciation of Machinery, Accounts Payable, Capital Stock, Surplus, Payroll, Direct Labor, Factory Expenses, Selling Expenses, General Administrative Expenses, Sales.

(*c*) Take a trial balance before closing.

QUESTIONS FOR DISCUSSION

1. Explain the chief differences from the operating standpoint between a merchant and a manufacturer.
2. How do the above differences affect the bookkeeping procedure?
3. What additional information must be recorded on the books in a manufacturing business?
4. How does the classification of expenses of a manufacturing concern differ from that of a trading business?
5. Name the elements of manufacturing cost.
6. What is meant by raw material as applied to manufacturing? Does the term mean the same to all manufacturers?
7. How is labor classified and for what purpose is this classification made?
8. What type of expenses are a direct part of the cost of the product?
9. What is meant by "prime cost," "factory cost," "total cost"?
10. When goods are made to order and delivered to the customer as soon as completed, is a Finished Goods account necessary?
11. Name the three stages in manufacturing, and the corresponding accounts kept.
12. For what is each of the following accounts debited and credited and what does the balance represent: Raw Materials, Direct Labor, Factory Expenses, Work in Process, Finished Goods?
13. How are the accounts with Tools and Factory Supplies handled?
14. Explain the methods of handling payroll in large and small factories.
15. Is it possible to use manufacturing accounts without a Raw Materials account?

CHAPTER XXXIII

FINANCIAL STATEMENTS FOR MANUFACTURING

Financial Statements of a Manufacturing Business. — Because of the large number of items usually involved in finding the *cost of finished goods sold*, it is more convenient to divide the operating statement into two parts — the Cost of Goods Manufactured Statement and the Profit and Loss Statement. The total cost as shown by the cost of goods manufactured statement is carried to the profit and loss statement and corresponds to the Purchases item in the statement of a trading business.

Balance Sheet. — The balance sheet of the Ajax Manufacturing Company prepared from the items in the adjusted trial balance shown on page 282 is as follows:

The Ajax Manufacturing Company

Balance Sheet, December 31, 1927

ASSETS

Current Assets:			
Cash		$ 15,940.00	
Accounts Receivable		45,000.00	$ 60,940.00
Inventories:			
Raw Materials		$ 72,000.00	
Work in Process		24,500.00	
Finished Goods		38,600.00	
Factory Supplies		1,000.00	136,100.00
Fixed Assets:			
Plant and Equipment		$125,000.00	
Less--Reserve for Depreciation		38,000.00	87,000.00
Total Assets			$284,040.00

LIABILITIES AND CAPITAL

Current Liabilities:			
Accounts Payable			$ 39,500.00
Capital:			
Capital Stock		$150,000.00	
Surplus:			
Balance Dec. 31, 1926	$31,250.00		
Add--Net Profit for the Year	63,290.00	94,540.00	
Net Worth Dec. 31, 1927			244,540.00
Total Liabilities and Capital			$284,040.00

The same form of balance sheet may be used both for a manufacturing business and for a trading business. The inventories representing raw materials and supplies, goods in process, and finished goods are usually shown in a special group headed "Inventories." The intangible assets such as Patent Rights, etc., when present, are shown under special group headings. The fixed assets, Plant and Machinery, are shown in the same manner as other equipment items already explained.

Cost of Goods Manufactured Statement. — Instead of inserting the detail of the cost of goods manufactured in the profit and loss statement a separate statement, such as the one shown below for the Ajax Manufacturing Co., is used, the result of which is transferred to the *cost of goods sold* section of the profit and loss statement. This statement contains all expenses incurred in making the product. They are grouped under four headings — Work in Process, Raw Materials Used, Direct Labor, and Factory Expenses.

The order and arrangement of the items are as follows: To the work in process at the *beginning of the year* are added the cost of material used, direct labor, and factory expenses, in order to find the *total factory cost.* From the total factory cost is deducted the work in process at the *close of the year,* in order to find the *net cost of goods manufactured.*

The Ajax Manufacturing Company
Cost of Goods Manufactured Statement
for Year Ending December 31, 1927

Work in Process December 31, 1926		$ 12,500.00
Raw Materials Used:		
Inventory December 31, 1926	$ 24,500.00	
Net Purchases during the year	148,500.00	
Total Cost of Material	$173,000.00	
Deduct--Inventory December 31, 1927	72,000.00	101,000.00
Direct Labor		246,800.00
Factory Expenses:		
Repairs	$ 3,250.00	
Depreciation	20,000.00	
Indirect Labor	15,200.00	
Supplies Used	4,000.00	
Sundries	15,410.00	57,860.00
Total Factory Cost		$418,160.00
Deduct--Work in Process December 31, 1927		24,500.00
Net Cost of Goods Manufactured		$393,660.00

Profit and Loss Statement — Manufacturing. — The following statement of the Ajax Manufacturing Co. illustrates the type of operating statement that may be used for a manufacturing business. The details of the cost of goods manufactured are shown on page 286, the net cost being transferred to this statement in the Cost of Goods Sold section. The general form of the statement is the same as for those previously explained.

The Ajax Manufacturing Company
Profit and Loss Statement for the Year Ending December 31, 1927

Net Sales of Finished Goods		$462,000.00
Deduct--Cost of Goods Sold:		
Inventory of Finished Goods December 31, 1926	$ 27,250.00	
Cost of Goods Manufactured during the Period	393,660.00	
Total Cost of Finished Goods	$420,910.00	
Deduct--Inventory December 31, 1927	38,600.00	382,310.00
Gross Profit on Sales		$ 79,690.00
Deduct--Operating Expenses:		
Selling Expenses	$ 8,650.00	
General Administrative Expenses	7,750.00	16,400.00
Net Profit		$ 63,290.00

EXERCISE 33-a

The following items are taken from the books of The Lima Mfg. Co. on October 31, 1927.

Raw Material Inventory, October 31, 1926	$143,629.00
Raw Material Inventory, October 31, 1927	180,278.50
Raw Material Purchases	459,923.50
Work in Process October 31, 1926	31,298.00
Work in Process October 31, 1927	23,115.50
Direct Labor	175,775.50
Indirect Labor	10,339.00
Heat, Light, and Power	21,360.00
Factory Supplies	4,276.50
Repairs	16,164.50
Taxes on Plant	5,675.00
Depreciation of Plant	14,050.00
Insurance on Plant	2,372.00
General Factory Expenses	7,525.50

Required:

Set up a statement for the year ending October 31, 1927 showing cost of goods manufactured. Use form shown on page 286.

EXERCISE 33-b

The fiscal year of The Western Mfg. Co. ends December 31, 19—. You are required to make up a statement in regular form of the cost of goods manufactured for the year, using such of the following figures as may be necessary for the purpose:

Purchases of Material including freight	$ 50,000.00
Material Used during the year	37,500.00
Factory Supplies Used	12,500.00
Wages	61,250.00
Fuel	1,250.00
Repairs	1,000.00
General Factory Expenses	2,500.00
Selling Expenses	25,000.00
Interest Paid	750.00
Purchases Discount	250.00
Gross Sales	137,500.00
Inventories January 1, 19—:	
Raw Material	57,500.00
Factory Supplies	17,500.00
Finished Goods	22,500.00
Work in Process	12,500.00
Inventories December 31, 19—:	
Raw Material	70,000.00
Factory Supplies	5,000.00
Finished Goods	30,000.00
Work in Process	11,000.00

Required:

Cost of Goods Manufactured Statement.

EXERCISE 33-c

The Eclipse Manufacturing Corporation was formed on July 1, 19— with a paid-up capital of $300,000. The following items are found on the books December 31, 19—:

Raw Material Purchased	$75,000.00
Work in Process	15,000.00
Finished Goods	55,000.00
Factory Supplies and Expenses	750.00
Direct Labor	56,250.00
Indirect Labor	4,500.00

EXERCISE 33-c (Cont.)

Superintendents' Salaries	2,250.00
Foremen's Salaries	1,500.00
Salesmen's Salaries	3,000.00
Officers' Salaries	4,500.00
Salesmen's Expenses	1,500.00
Officers' Expenses	750.00
Cost Department Salaries	1,500.00
Freight Outward	1,500.00
Freight Inward	2,250.00
Advertising	4,500.00
Depreciation of Plant and Machinery	7,500.00
Bad Debts	750.00
Shipping Department Expenses	2,250.00
Power	750.00
Sales	108,750.00
Allowances to Customers	1,500.00
Sales Discounts	2,250.00
Interest Expense	1,500.00
Purchases Discount	1,200.00
Raw Material on Hand	3,000.00

Required:

(*a*) Cost of Goods Manufactured Statement.

(*b*) Profit and Loss Statement.

EXERCISE 33-d

Refer to ledger and trial balance called for in solution to Exercise 32-a and prepare:

(*a*) Cost of Goods Manufactured Statement

(*b*) Profit and Loss Statement

(*c*) Balance Sheet

EXERCISE 33-e

Refer to ledger and trial balance called for in solution to Exercise 32-b and prepare·

(*a*) Cost of Goods Manufactured Statement

(*b*) Profit and Loss Statement

(*c*) Balance Sheet

EXERCISE 33-f

Trial Balance, December 31, 1928

Cash	$ 45,805.26	
Accounts Receivable	124,633.00	
Notes Receivable	8,676.90	
Raw Materials Inventory, December 31, 1927	28,756.80	
Work in Process, December 31, 1927	47,263.00	
Finished Goods, December 31, 1927	31,372.62	
Real Estate	162,070.00	
Machinery and Equipment	115,500.00	
Tools	10,518.00	
Lasts and Patterns	60,520.00	
Office Equipment	6,792.00	
Goodwill	70,000.00	
Accounts Payable		$ 37,161.40
Notes Payable		13,000.00
Mortgages Payable		40,000.00
Reserve for Depreciation of Lasts and Patterns		30,823.50
Reserve For Bad Debts		722.44
Capital Stock		400,000.00
Surplus		14,658.92
Sales		839,504.70
Raw Material Purchased	290,963.38	
Factory Supplies	17,635.24	
Direct Labor	220,743.68	
Indirect Labor	10,386.00	
Freight Inward	3,690.50	
Sundry Factory Expenses	28,560.60	
Selling Expenses	51,585.30	
General Expenses	32,247.50	
Interest Expense	902.82	
Discount on Purchases		14,580.80
Discount on Sales	17,737.50	
Sales Returns and Allowances	4,091.66	
	$1,390,451.76	$1,390,451.76

Reserves are to be set up as follows: Depreciation of machinery, 10%; depreciation of tools, 15%; depreciation of lasts and patterns, 25%; reserve for loss on bad debts in an amount which when added to the reserve already set up for that purpose will equal the sum of 1% of the accounts receivable.

Inventories December 31, 1928:

Raw materials	$10,794.48	Fuel	$3,184.34
Work in process	36,986.24	Factory Supplies	1,640.40
Finished goods	17,797.22		

Required:

(*a*) Necessary adjusting entries in journal form.
(*b*) Cost of goods manufactured statement.
(*c*) Profit and loss statement.
(*d*) Balance sheet.

QUESTIONS FOR DISCUSSION

1. In what respect do the financial statements of a manufacturer differ from those of a merchant or trader?

2. What new accounts may properly appear in the balance sheet of a manufacturing corporation which uses many expensive machines, carries a large stock of raw material and finished goods, and is in full operation at the time the statements are made up?

3. If a factory completes all orders on hand and shuts down at the end of the fiscal period, what effect will it have upon the items in the balance sheet?

4. What intangible assets are sometimes found in the balance sheet of a manufacturer?

5. Why is it thought advisable to divide the operating statement of a factory into two parts? Name them and outline what is contained in each.

6. What account in the ledger contains the same information as the cost of goods manufactured statement?

7. How do the form and arrangement of a profit and loss statement of a manufacturing concern differ from that of a merchandising business?

8. Under what circumstances would there be no account for Raw Materials in the balance sheet?

9. Name in order the four headings usually found in the cost of goods manufactured statement.

10. State the source of the data necessary to find the cost of raw materials used during the period, as shown in the cost of goods manufactured statement.

CHAPTER XXXIV

CLOSING ENTRIES FOR MANUFACTURING

Closing Journal Entries. — The journal entries required to close the ledger of a manufacturing business naturally divide themselves into two groups. One group of entries is taken from the cost of goods manufactured statement and the other from the profit and loss statement. The items showing total factory costs are summarized in the Work in Process account, while those showing trading costs are summarized in the Profit and Loss account. In each case the entries are made in the order in which they appear in the statements. The cost of goods manufactured statement shows in detail the items appearing in the Work in Process account in the ledger after the closing entries have been made. The closing entries for the Ajax Manufacturing Company, December 31, 1927, taken from the statements illustrated in Chapter XXXIII appear below.

The following items are taken from the manufacturing statement:

For raw materials transferred from store room to factory:		
Work in Process	$101,000.00	
Raw Materials		$101,000.00
To transfer to Work in Process account cost of materials used during the year.		
For direct labor used in the factory:		
Work in Process	246,800.00	
Direct Labor		246,800.00
To transfer to Work in Process account cost of direct labor expended during the year.		
For expenses incurred on account of the factory:		
Work in Process	57,860.00	
* Factory Expenses		57,860.00
To transfer to Work in Process account cost of expenses due to manufacturing for the year.		

* These may be shown in several accounts, in which case the detailed accounts are credited.

For completed goods transferred from the factory to the stock room:

Finished Goods	$393,660.00	
Work in Process		$393,660.00
To transfer to Finished Goods account the cost of goods manufactured during the year.		

The following items taken from the profit and loss statement are set up in the usual manner:

Sales	$382,310.00	
Finished Goods		$382,310.00
To transfer to Sales account cost of goods sold during the year.		
Sales	79,690.00	
Profit and Loss		79,690.00
To transfer to Profit and Loss account gross profit on sales for the year.		
Profit and Loss	16,400.00	
Selling Expenses		8,650.00
General Administrative Expenses		7,750.00
To transfer to Profit and Loss account operating expenses for the year.		
Profit and Loss	63,290.00	
Surplus		63,290.00
To transfer to Surplus account the net profit for the year.		

Ledger Accounts after Closing. — The accounts in the ledger of the Ajax Manufacturing Company, shown on pages 280–282, affected by the closing entries are shown below after the posting has been completed and the accounts ruled off. The asset and liability accounts not affected by the above entries are omitted.

Raw Materials

1926						1927					
Dec.	31	Inventory		24500	00	Dec.	31	To Work in Process		101000	00
1927											
Dec.	31	Purchases		148500	00		31	Inventory		72000	00
				173000	00					173000	00
Dec.	31	Inventory		72000	00						

Direct Labor

1927						1927				
Dec.	31	Payroll		246800 00		Dec.	31	To Work in Process		246800 00

Factory Expenses

1927					1927				
Dec.	31	Repairs		3250 00	Dec.	31	To Work in Process		57860 00
	31	Sundries		15410 00					
	31	Depr.		20000 00					
	31	Ind. Labor		15200 00					
	31	Supplies		4000 00					
				57860 00					57860 00

Work in Process

1926					1927				
Dec.	31	Inventory		12500 00	Dec.	31	To Finished Goods		393660 00
1927									
Dec.	31	Materials		101000 00		31	Inventory		24500 00
	31	Dir. Labor		246800 00					
	31	Factory Exp		57860 00					
				418160 00					418160 00
Dec.	31	Inventory		24500 00					

Finished Goods

1926					1927				
Dec.	31	Inventory		27250 00	Dec.	31	To Sales		382310 00
1927						31	Inventory		38600 00
Dec.	31	From Work in Process		393660 00					
				420910 00					420910 00
Dec.	31	Inventory		38600 00					

Sales

1927					1927				
Dec.	31	Sales Cost		382310 00	Dec.	31	Sales		462000 00
	31	To P.and L.		79690 00					
				462000 00					462000 00

Selling Expenses

1927					1927				
Dec.	31	Sundries	2150 00		Dec.	31	To P.and L.	8650 00	
	31	Salaries	6500 00						
			8650 00					8650 00	

General Administrative Expenses

1927					1927				
Dec.	31	Sundries	3250 00		Dec.	31	To P.and L.	7750 00	
	31	Salaries	4500 00						
			7750 00					7750 00	

Profit and Loss

1927					1927				
Dec.	31	Selling Exp	8650 00		Dec.	31	Gr. Profit	79690 00	
	31	Admr. Exp.	7750 00						
	31	To Surplus	63290 00						
			79690 00					79690 00	

Surplus

1927					1926				
Dec.	31	Balance	94540 00		Dec.	31	Balance	31250 00	
					1927				
					Dec.	31	Net Profit	63290 00	
			94540 00					94540 00	
					Dec.	31	Balance	94540 00	

Trial Balance After Closing. — This trial balance, taken from the ledger of the Ajax Manufacturing Company after closing, includes all items in the ledger remaining open after the closing journal entries have been posted:

Ajax Manufacturing Company

Post-Closing Trial Balance, December 31, 1927

	Cash	15940 00	
	Accounts Receivable	45000 00	
	Raw Materials	72000 00	
	Work in Process	24500 00	
	Factory Supplies	1000 00	
	Finished Goods	38600 00	
	Plant and Equipment	125000 00	
	Reserve for Depreciation		38000 00
	Accounts Payable		39500 00
	Capital Stock		150000 00
	Surplus		94540 00
		322040 00	322040 00

Finding Unit Costs. — In the foregoing discussion of factory accounts and in the statements shown on pages 286 and 287 only the total cost of operating the factory has been shown. This does not show what it cost to make each unit produced whether that be a pound, ton, yard, gallon, or an individual article. In order to find the cost of each unit or article produced, if the factory is a large one with several departments producing several kinds of products, it is necessary to have a cost accounting system which will show in great detail the various factory expenses. If the factory is small, and the manufacturing process simple, unit costs may be found from the accounts with Raw Material, Labor, and Factory Expenses. The cost of operating the factory is obtained from the manufacturing statement. It is necessary to keep a record of the number of units produced during the fiscal period. The total factory cost divided by the total units produced will give the cost per unit. This cost may be analyzed to show cost of material, labor, and various factory expenses.

For instance, assume that the Ajax Manufacturing Company is a factory that is in continuous operation and produces only one kind of product. During the year ending December 31, 1927 the production reports show that 21,000 tons were produced. The average cost per unit for the year is found by dividing factory cost, $393,660, by 21,000 tons.

Tons Produced	Total Factory Cost	Cost per Ton
21,000	$393,660	$18.75

EXERCISE 34-a

Refer to the cost of goods manufactured statement required in the solution to Exercise 33-a.

Required:

(*a*) Prepare closing journal entries. (Use detailed expense accounts.)

(*b*) Set up T ledger account for Work in Process and insert proper items in accordance with the above.

EXERCISE 34-b

Refer to the financial statements required in the solution to Exercise 33-c and prepare closing journal entries from both statements. (Use detailed expense accounts.)

EXERCISE 34-c

Refer to the financial statements required in the solution to Exercise 33-d.

(*a*) Prepare closing journal entries affecting the items in the cost of goods manufactured statement in accordance with illustration shown on page 292.

(*b*) Prepare closing journal entries for the items shown in the profit and loss statement.

(*c*) Post the closing entries called for in (*a*) and (*b*) to the ledger required in Exercise 32-a and rule the accounts as illustrated on pages 293–295.

(*d*) Prepare a post closing trial balance.

EXERCISE 34-d

Refer to the financial statements required in the solution to Exercise 33-e and follow instructions given for Exercise 34-c above, using ledger required in Exercise 32-b.

EXERCISE 34-e

These items are taken from the trial balance of a manufacturing concern as of May 31, after adjustments have been made, except those for inventories shown below.

Finished Goods Inventory, May 1	$ 450.00
Finished Goods Purchased	292.50
Raw Materials Inventory, May 1	8,508.27
Sales	9,985.26
Sales Returns	179.70
Raw Materials Purchased	2,820.42
Purchase Returns — Raw Material	41.46
Work in Process, May 1	1,800.48
Salesmen's Commissions	49.65
Shipping Expenses	34.20
Freight Outward	52.47
Direct Labor	823.02
Factory Supplies	176.25
Heat, Light and Power	129.00
Office Salaries and Expenses	364.71
Salesmen's Salaries	300.00
Loss on Bad Debts	33.48
Sales Discount	58.50
Freight and Cartage Inward	31.27
Interest Expense	22.50
Rent of Salesroom	90.00
Indirect Labor	108.48
Superintendence	150.00
Factory Rent	150.00
Purchases Discount	38.88
Depreciation of Plant	144.75
Rent Income — Second floor of factory sublet	75.00
Insurance on Machinery	9.15
Taxes on Plant	54.00
Repairs and Renewals	48.24
Advertising	25.14

Inventories on May 31 were as follows:

Factory Supplies	$ 37.50
Raw Materials	5,977.26
Work in Process	2,202.21
Finished Goods	496.29

Required:

(*a*) Statement showing cost of goods manufactured during month of May.

(*b*) Profit and loss statement for month ending May 31, 19—

(*c*) Closing entries that apply to the manufacturing accounts.

EXERCISE 34-f

The Excelsior Manufacturing Company is engaged in the manufacture of bicycles. On December 31, 19— the trial balance contains the following items:

Raw Material Inventory January 1, 19—	$ 6,300.00
Finished Bicycles Inventory January 1, 19— (1,500 bicycles at $20)	30,000.00
Raw Material Purchases	31,500.00
Direct Labor	47,250.00
Factory Expenses	14,400.00
Agents' Commissions	18,750.00
General Administrative Expenses	9,650.00
Selling Expenses	6,560.00
Loss on Bad Accounts	1,500.00
Sales — 5,000 bicycles	175,000.00

The inventory of raw materials December 31, 19— amounted to $1,800. The inventory of finished bicycles ready for sale amounted to 1,000, which are priced at cost. 4,500 bicycles were manufactured during the year.

Required:

(*a*) Cost of goods manufactured statement showing the cost of each bicycle manufactured during the year.

(*b*) Gross profit on sales and average gross profit on each bicycle sold, those on hand at the beginning of the year all being sold.

(*c*) Net profit and average net profit on each bicycle sold.

QUESTIONS FOR DISCUSSION

1. In what way may the closing journal entries for a manufacturing concern be said to divide themselves into two groups?

2. From what source is the data taken to prepare the entries to close the various accounts that affect the cost of the product?

3. What is meant by "unit costs"?

4. Is it possible to find unit costs without an elaborate cost system? Outline a method.

5. Do the closing entries for the items in the profit and loss statement of a manufacturing concern differ in any respect from those a merchant makes in closing his books?

6. Which of the manufacturing accounts are ruled off at the time the ledger is closed?

7. What disposition is made of freight on purchases in the books of a manufacturing concern?

8. If a manufacturer imports his material from Europe and pays duty and exchange, where will these items appear in the statements?

SUMMARY OF CHAPTERS XXXII-XXXIV

Manufacturing accounts are those that record the cost of materials and the expense of converting them into a finished marketable product. A group of special accounts is kept to show the cost of the product at the various stages in the factory process. The factory stages are: raw materials, work in process, and finished goods.

The primary cost elements in any product are raw material, labor, and factory expenses. The latter have to do with the general operation of the plant and include every item of cost except direct material and direct labor, both of which refer to costs that may be applied directly to the cost of the product. The cost of raw material plus the cost of direct labor is the *prime cost* of the goods. Prime cost plus factory expenses is *factory cost*. Factory cost plus selling and administrative expenses and profit is the *selling price*.

Detailed accounts are kept in the ledger with Raw Materials, Direct Labor, Work in Process, Finished Goods, and Factory Expenses. Salaries and wages are charged to a Payroll account and distributed to the proper cost accounts at the end of the period.

The balance sheet of a manufacturing business is arranged in much the same form as that of a trading business except that inventories are shown under a separate heading, and there is usually a greater variety of fixed assets. The operating statement is divided into two parts with the following headings: "Cost of Goods Manufactured Statement" and "Profit and Loss Statement." The first shows the detail of factory cost and the latter the profit from the sale of goods and the cost of marketing the product. The general form of the profit and loss statement is the same as that for a trading business.

The closing entries are made from the operating statements. The items in the manufacturing statement are summarized in the Work in Process account, and those in the profit and loss statement in the Profit and Loss account as usual.

CHAPTER XXXV

THE VOUCHER SYSTEM

Nature and Purpose of the Voucher System of Recording Purchases. — In a manufacturing business the problems in connection with purchases are much more complicated than in a trading concern. Not only are goods in the form of raw materials purchased but also various kinds of labor, and a larger variety of assets, services and expenses. If the business is large much authority must be delegated by the management to subordinate employees. The voucher system has been devised in order to handle purchases more efficiently under these conditions and to fix responsibility for action. It provides that no funds can be disbursed without the preparation of a voucher which must be approved for payment by the proper official. The voucher also certifies that the transaction is correct as to quantities, prices, extensions, terms, and accounts to be charged.

The Voucher Jacket. — When the invoice for a purchase of goods is received it is placed on file until the goods arrive. When the goods are delivered they are checked with the invoice and if found correct a voucher jacket is made out covering the transaction. A *voucher jacket* is a covering for the purchase invoice. The front or inside of the jacket is in the form of an invoice and provides for the number of the voucher, name of the creditor, date, brief summary of the invoice, and the signature of the purchasing agent, the auditor, the general manager, treasurer or other official whose duty it is to vouch for certain items in the invoice. On the back or outside of the jacket there is space for a brief record of the voucher such as number, name of creditor, amount of invoice, when paid, check number, and distribution of charges to the various accounts affected such as Raw Materials, Factory Expenses, Selling Expenses, etc.

When the voucher jacket has been approved by the proper officer and a record made both on the jacket and in the books, the invoice is attached to the jacket which is folded with the back out and filed with "Unpaid Vouchers" in such a way as to come up for payment automatically on the due date. Sometimes invoices of a creditor are vouchered only once or twice a month; in which case several invoices may be attached to the same voucher. The vouchers are numbered consecutively. When due, a check is drawn, recorded in the books and on the jacket, and sent to the creditor. The voucher is then

filed in the "Paid Vouchers" file and indexed in such a way as to make the record of all transactions with each creditor as accessible as possible.

The exact form of the voucher jacket varies with each business as it must be designed to include the classification of accounts used in each particular business. The following form illustrates the general form and arrangement of a voucher jacket for use in connection with the voucher check illustrated on page 303:

THE LENNOX MANUFACTURING CO.

PITTSBURGH, PA. No. 111

To Petty Cash Cr. Date Jan. 15, 19--

Date	Description	Items	Amount
1926 Jan. 1	To replenish cash in accordance with analysis sheet herewith		42 50

Invoices Approved	Extensions and Classification Approved	Payment Authorized
T. E. Ward	P. L. Fox	R. F. Brill
Purchasing Agent	Auditor	Treasurer

Illustration — Voucher Jacket (Front)

The voucher jacket may have a form of receipt printed at the bottom or on the back so that when the voucher is paid it may be sent to the creditor with the check with instructions for the creditor to receipt it in the spaces provided for that purpose and return it. Under this procedure the original invoices are kept on file with a copy of the voucher until the receipted voucher is returned, then it is attached to the bills and filed in the "Paid Vouchers" file. This practice is not generally followed for reasons stated on the following page.

Month of January

No. 111 Amount $ 42.50

In favor of

Petty Cash

Voucher Register Page

PAYMENT

Date Jan. 15, 19--

Check No. 57

Amount of Voucher $ 42.50

Cash Discount % $

Amount of Check $ 42.50

DISTRIBUTION	Amount
Accounts Debited	
Raw Materials:	
Express	2 25
Payroll:	
Factory	5 00
Total for'd	7 25

DISTRIBUTION (Continued)	Amount
Brought for'd	7 25
Factory Expenses:	
Supplies	5 25
Selling Expenses:	
Circulars	4 50
Gen'l Admr. Expenses:	
Office Supplies	20 00
Delivery Expenses:	
Oil and Gasoline	5 50
Sundry Debits:	
Total Vouchers Payable Credit	42 50

Illustration — Voucher Jacket (Back)

Voucher Check. — When vouchers are sent to creditors to be receipted, frequently a voucher is lost or the creditor neglects to return it. To avoid losing the voucher it is not sent to the creditor but payment is made by a voucher check. The voucher check is designed so that reference may be made

to the voucher and in this way it operates as a legal receipt. When the check is returned through the bank, it is filed with the voucher jacket that bears the number on the check and which contains the invoices for which the check is in payment. The form of the voucher check resembles that of an ordinary check, except that the voucher check provides a space at the left end in which may be entered the voucher number, dates and numbers of invoices for which it is given in payment.

VOUCHER No. 111

This check is issued in payment of items listed below. Endorsement hereof is acknowledgment of payment.

Date	Items	Amount
19-- Jan. 15	Petty Cash	42 50
	Total	42 50

No receipt required. Return if incorrect.

FITTSBURGH, PA., Jan. 15, 19-- No. 57

CITIZENS NATIONAL BANK

Pay to the Order of Petty Cash $ 42.50

Forty-two ~~~~~ 50/100 Dollars

R. F. Brill
Treasurer

Illustration — Voucher Check

Voucher Register. — This book contains a record of all vouchers issued and is the most important record in a voucher system. It is a combination of the Purchases Journal and the Accounts Payable Ledger. When the Voucher Register is used as a book of original entry, ledger accounts with creditors may be dispensed with. The usual Purchases Journal contains only purchases of merchandise, while the *Voucher Register* contains a record of every form of commodity or service purchased for the business. Accordingly many columns are necessary in the Voucher Register in order to provide proper distribution for the various purchases and the accompanying data. It generally extends across both pages as the book stands open and contains columns showing the date of entry, voucher number, name of creditor, particulars, date paid, number of check issued in payment, a Vouchers Payable credit column followed to the right by as many debit columns as may be necessary to properly classify the charges entered therein. At the extreme right a space is provided for sundry debit items showing the name of the account and the amount.

Every transaction entered in this book appears as a *credit* to Vouchers Pay-

VOUCHER

Date	Voucher No.	In Favor of	Particulars	Payment Date	Payment Ck. No.	Vouchers Payable Cr.	Raw Materials Dr.
19--				19--			
Jan. 1	101	Petty Cash	Establish fund	Jan. 1	52	50 00	
1	102	Wilson Fur. Co.	Net Cash	1	53	250 00	
3	103	Brown-Hayes Co.	2/10 n/30	10	J/2 $75. Ck. 95	1875 00	1875 00
5	104	Payroll	To date	5	54	810 00	
6	105	Boston Pub. Co.	Net	20	59	46 50	
8	106	Foster Supply Co.	n/30			72 00	
10	107	Collins and Wells	n/30 days	10	Note GJ/2	2210 00	2210 00
10	108	Central Garage Co.	Net			28 25	
10	109	C. R. Landry	Net Cash	10	55	1200 00	
12	110	Payroll	To date	12	56	800 00	
15	111	Petty Cash	Replenish fund	15	57	42 50	2 25
19	112	Payroll	To date	19	58	790 00	
20	113	Geo. Bain	2/10 n/30	20	96	860 00	860 00
25	114	Humphrey Mach. Co.	n/30			2410 00	
26	115	Payroll	To date	26	60	795 00	
28	116	G. and E. Light Co.	Net			52 00	
30	117	H. C. Evans and Co.	2/10 n/30			340 00	340 00
31	118	Petty Cash	Replenish fund	31	61	32 00	
	L.F.						
31		Vouchers Payable	Cr.			12663 25	
31		Raw Materials	Dr.				5287 25
31		Payroll	Dr.				
31		Factory Expenses	Dr.				
31		Selling Expenses	Dr.				
31		Gen'l Admr. Exp.	Dr.				
31		Delivery Expenses	Dr.				
31	✓	Sundry Debits					

Illustration — Voucher Register (left)

able account and a *debit* to the proper account chargeable with the invoice. When an invoice or expense bill is received and is approved a voucher jacket is made out. Each item is certified to by the proper persons and a distribution of charges is made on the back of the voucher; from this the distribution record is made in the Voucher Register.

The posting from the Voucher Register is done at the end of the month only. At that time the various columns are footed and the book proved by ascertaining if the sum of the totals of the various debit columns equals the total of the Vouchers Payable column. The footing of the Vouchers Payable column is posted to the credit of Vouchers Payable account in the General Ledger. The details of the Sundry Debits column and the footings of the special debit columns are posted to the debit of the proper accounts in the ledger.

REGISTER

Payroll Dr.	Factory Expenses Dr.	Selling Expenses Dr.	Gen Admr Expenses Dr.	Delivery Expenses Dr.	SUNDRY DEBITS Name of Account	L. F.	Amount
					Imprest Cash Fund		50 00
					Office Equipment		250 00
810 00							
	72 00	46 50					
				28 25			
800 00					Delivery Equipment		1200 00
5 00	5 25	4 50	20 00	5 50			
790 00							
					Machinery		2410 00
795 00							
	20 00		32 00				
	2 00	10 00	15 00	5 00			
3200 00	99 25	61 00	67 00	38 75			3910 00

Illustration — Voucher Register (right)

The details of the Vouchers Payable column are not posted. A schedule of accounts payable may be prepared by going through the Vouchers Payable column and listing all items not marked " paid " in the Payment column which appears to the left of the amount. The total of this schedule should agree with the balance of the Vouchers Payable account in the General Ledger and with the total of the vouchers in the " Unpaid Voucher " file. A form of Voucher Register is shown above.

Special Items in the Voucher Register. — In order for the voucher system to work well all transactions should follow a fixed routine. Adjustments of returns and allowances should be made on the bill before it is vouchered, and it is assumed that all invoices will be paid *in full in cash* when due. Partial payments, allowances, and payment by note or acceptances complicate the system.

(1) *Purchase Returns and Allowances.* — Whenever possible all adjustments should be made before the voucher jacket is made out and recorded in the register. A ledger account is not kept with purchase returns and allowances. If necessary to make an adjustment, a new voucher may be made out and the previous voucher canceled by drawing a red line through it in the Voucher Register and inserting the new voucher number in the Payment column.

Another method is to make a journal entry debiting Vouchers Payable and crediting the proper purchase account, and then post the debit to the Payment column of the Voucher Register, inserting the journal folio, and make a proper notation on the voucher jacket so that when paid the amount will be deducted. Neither of these methods is entirely satisfactory.

The second method is illustrated in the Voucher Register shown on pages 304 and 305 in connection with Voucher No. 103. A portion of the raw material purchased from Brown-Hayes Co. on January 3 was found to be of poor quality and a credit memo was received for $75. As the voucher jacket had been approved and recorded, an entry was made in the General Journal as follows:

Vouchers Payable (Voucher 103)	$75.00	
Raw Materials		$75.00
Allowance for poor quality of materials invoiced January 3, Voucher No. 103.		

This entry was posted to the General Ledger, debiting Vouchers Payable account and crediting Raw Materials. A notation was also made in the Payment column of the Voucher Register as shown on page 304 and also on the voucher jacket on file in "Unpaid Vouchers" file, so that the amount would be deducted when the voucher was paid.

(2) *Partial Payments.* — When a partial payment is made, either the original voucher is canceled and two new vouchers issued, one for the partial payment and one for the balance, or the partial payment is noted in the Payment column and on the voucher jacket so that deduction may be made when the payment is completed.

(3) *Payment by Note.* — When notes are offered or drafts are accepted in payment of vouchers for purchases of goods, a journal entry is necessary debiting Vouchers Payable, inserting the voucher number of the invoice paid as shown on the following page, and crediting Notes Payable for the note or trade acceptance issued. The debit is then posted to the Payment column in the Voucher Register opposite the number of the voucher canceled. This is illustrated in Voucher Register on page 304 in connection with voucher number 107.

A 30-day note was issued to Collins and Wells and recorded in the General Journal as follows:

Vouchers Payable (Voucher No. 107)	$2,210.00	
Notes Payable		$2,210.00
30-day note issued to Collins and Wells in settlement of Voucher 107.		

This entry was posted to the General Ledger debiting Vouchers Payable and crediting Notes Payable. The debit was then posted to the Payment column of the Voucher Register and journal folio shown. Proper notation was also made on the voucher jacket.

Cash Receipts and Disbursements. — The operation of the voucher system does not necessarily have any effect upon the form of the *Cash Receipts Journal*. Columns are provided in that book to classify the receipts properly.

The *Cash Payments Journal*, however, is much simplified under this system. All payments are made by check and each check is issued in payment of a voucher. It is, therefore, unnecessary to have distribution columns for cash payments. Because the Cash Payments Journal becomes simply a register of checks issued it is called a *Check Register*. The Purchases Discount column is used as usual for deductions. The Check Register in its simplest form, therefore, contains only three amount columns: Vouchers Payable debit, Purchases Discount and Cash or Bank credit. If a bank account is kept in the ledger and deposits are made in more than one bank, columns may be added for each bank. At the end of the month the columns are footed, the book proved and the totals posted to the General Ledger, Vouchers Payable being debited and the Purchases Discount and Bank accounts credited.

If desired, the check book stub may be combined with the Check Register by inserting in the Check Register three columns for each bank instead of one as shown in the illustration on page 308. Under this arrangement the columns for the Citizens National Bank would appear as follows at the end of January 1, 19—:

CITIZENS NATIONAL BANK		
Deposits	Checks	Balance
		1650 00
750 00	350 00	1200 00

The amount of cash deposited each day is entered in the Deposits column. The amount of checks drawn on this bank is recorded in the Checks column. The balance on hand at the end of the day, which is found by adding to the balance at the beginning of the day the deposits for the day and deducting the checks issued, is entered in the Balance column.

During the month, checks issued are recorded in the Check Register. As each voucher is paid it is taken from the "Unpaid Voucher" file and proper notation made on the back of the jacket and in the Payment column of the voucher register; after which the voucher is filed with "Paid Vouchers." A form of Check Register is shown below:

CHECK REGISTER

Date	Check No.	Voucher No.	L. F.	In Favor Of	Vouchers Payable Dr.	Purchases Discount Cr.	Citizens National Cr.	Liberty Trust Cr.
19--								
Jan. 1	52	101		Petty Cash	50 00		50 00	
1	53	102		Wilson Furniture Co.	250 00		250 00	
5	54	104		Payroll	810 00		810 00	
10	95	103		Brown-Hayes Co.	1800 00	36 00		1764 00
12	55	109		C. R. Landry	1200 00		1200 00	
12	56	110		Payroll	800 00		800 00	
15	57	111		Petty Cash	42 50		42 50	
19	58	112		Payroll	790 00		790 00	
20	59	105		Boston Publishing Co.	46 50		46 50	
20	96	113		George Bain	860 00	17 20		842 80
26	60	115		Payroll	795 00		795 00	
31	61	118		Petty Cash	32 00		32 00	
						53 20	4816 00	2606 80
31				Vouchers Payable Dr.	7476 00			
31				Purchases Discount Cr.		53 20		
31				Citizens National Bank Cr.			4816 00	
31				Liberty Trust Co. Cr.				2606 80

Illustration — Check Register

Vouchers Payable Account. — This account may be used in the ledger in place of Accounts Payable account when a voucher system is in use. It summarizes the transactions with creditors, the debits and credits being as follows:

VOUCHERS PAYABLE

Debit:

For cash payments to creditors as shown by the footing of the Vouchers Payable Dr. column in the Check Register at the end of the month.

For allowances made by creditors as shown by the General Journal.

For notes and acceptances issued to creditors as shown by the General Journal.

Credit:

For total purchases of materials, supplies, services, expenses, and sundry assets as shown by the footing of the Vouchers Payable Cr. column in the Voucher Register at the end of the month.

The balance of this account is a credit and represents the amount owing to creditors. This balance is a current liability and is shown in the balance sheet under the title of Accounts Payable. It should be supported by a detailed schedule of creditors' balances found by listing all vouchers not marked paid in the Voucher Register, as explained on page 305.

The Vouchers Payable account in the General Ledger, after posting the items from the books illustrated in this chapter, appears as follows:

Vouchers Payable

19--							19--					
Jan.	10		GJ	75	00		Jan.	31		VR	12663	25
	10		GJ	2210	00							
	31		CR	7476	00							
		Bal. 2902.25										

The schedule of creditors' balances taken from the Voucher Register, in the order in which they appear therein, is as follows:

Schedule of Creditors' Balances, January 31, 19--

	Foster Supply Co.	72 00	
	Central Garage Co.	28 25	
	Humphrey Machine Co.	2410 00	
	G. and E. Light Co.	52 00	
	H. C. Evans and Co.	340 00	
	Total as per General Ledger		2902 25

Advantages and Disadvantages of the Voucher System. —

Advantages:

(1) By dispensing with the Accounts Payable Ledger labor is saved as no posting to creditors' accounts is required.

(2) A complete classified record of all expenditures is provided.

(3) Responsibility is fixed upon proper officials for verifying, recording and payment of items.

(4) The form of the Cash Payments Journal is simplified as distribution columns are not necessary.

(5) A voucher jacket for each invoice provides a uniform size for filing.

(6) It secures a voucher for all payments.

(7) Auditing of the accounts is simplified.

Disadvantages:

(1) Inadequate provision for handling returns and allowances, partial payment of bills, or payment by note.

(2) Difficulty in determining the volume of business done with each creditor.

(3) All payments must go through the same routine and be approved by various officials whose absence causes delay and inconvenience.

EXERCISE 35-a

Vouchers for the following transactions were issued by the Watson Manufacturing Co. during the month of November, 1926:

Nov. 1 The Park Realty Co. for November rent, $500. Check #42 issued.
2 Thorp and Jones, for legal services, $100. Check issued.
3 Brighton Coal Co., $250, fuel for factory. Check issued.
4 Marion Foundry Co., factory supplies, $350, terms 1/10 n/30.
5 R. N. Warren & Co., Chicago, terms 1/10 n/30, $1,275, raw materials. Payroll to date, $1,150. Check #82.
6 General Electric Co., $854.20; for power, $750, and light and heat, $104.20.
8 Traveling salesmen, $430 for traveling expenses. Check issued.
10 To replenish petty cash fund of $100: Expended as per analysis; car fares, $10.50; office stationery, $15; repairs to typewriter, $7.50; postage stamps, $24.10; auto repairs, $12.50; advertising, $20; factory supplies, $8.50. Cash in drawer amounts to $1.90.
12 Payroll for week, $965. Auto Sales Co., delivery truck, $1,500, terms n/10.
14 W. B. Brown & Co., terms 2/10 n/30, raw materials $1,530.
15 Central Garage Co. storage of trucks, $50. Check issued.
18 Eclipse Foundry Co., for repairs to machinery, $130.20.
19 Payroll for week, $988.50.
24 Western Chemical Co., raw materials $2,450, terms 2/10 n/30.
25 Morgan Office Furniture Co., for office desk on account, $50.
26 Payroll for week, $1,057.
30 Geo. Wilson & Co., for raw materials $742.40, terms n/30.

Required:

(*a*) Design a Voucher Register similar to the form illustrated on pages 304 and 305 and record the above vouchers. Begin numbering vouchers with 126.

(*b*) Design a Check Register similar to the form illustrated on page 308. The payrolls were drawn on the Liberty Trust Co., all other checks on Citizens National Bank. Record all checks drawn as above. Bills are paid so as to take all discounts.

(*c*) Foot and rule the books and summarize for posting.

(*d*) Set up Vouchers Payable account as it would appear in the ledger after posting and prepare a list of unpaid vouchers to prove same.

EXERCISE 35-b

The McKinley Manufacturing Company is engaged in the manufacture of shoes at Lynn, Mass. All purchases and expenses are recorded in a Voucher Register which

contains spaces and money columns for the following in the order in which they are given, beginning at the left: Date, Voucher No., In Favor Of, Particulars, Vouchers Paid (Date, Check No., and Amount), Vouchers Payable, Materials, Factory Wages, Factory Supplies, Lasts and Patterns, Selling Expenses, General Administrative Expenses, and spaces for sundry debits.

The following transactions are taken from the books during the month of September, 19—:

1 A. M. Chambers and Company, office supplies, $36.05. (Begin numbering vouchers with 760.)
5 R. J. Brown, machinery, $64.80.
7 Eastern Tanning Company, sole leather, $726.37, terms 2/10 n/30.
7 J. C. Smith and Company, cotton waste, machine screws and belting, $22.59.
8 Stickney and Co., cartons, $232.50 terms, 2/10 n/30.
9 United Shoe Machine Company, royalties on 10,521 pairs shoes at 4 cents, $420.84. Check mailed. (Begin numbering checks with 430.)
9 W. D. Snyder Company, calf uppers, $1,620.
10 J. A. Frank and Co., 1 sewing machine, $125; eyelets and buttons, $217.65; total, $342.65.
14 Payroll, factory, $4,327.69; salesmen, $176.25; office help, $108; total, $4,611.94. Check issued.
15 Paid by check, A. M. Chambers and Company, Eastern Tanning Company, and Stickney and Co.
15 Ferson Oil Co., lubricating oil, $219.48.
20 Ross Company, uppers and soles, $3,609.
25 Malden Last Company, lasts, $648. Check issued in payment.
27 Brady Express Co., freight and cartage bills for month, $325. Check issued.
28 Payroll, administrative salaries, $1,800; factory, $4,560.90; salesmen, $220.50; office help, $120; total, $6,701.40. Check issued.
29 Lynn Gas Company, September bill, $176.40.
30 James Black, salesman, salary for September, $350; expenses, $175.35. Check issued.
30 Petty cash: month's expenses summarized as follows: office supplies, $29.48; factory supplies, $6.30; cleaning office, $30; telegrams, $11.25; express, $48.

Required:

(*a*) Design a Voucher Register according to the above outline and record therein the above transactions. In addition to the General Ledger accounts indicated by the above, accounts are kept with Royalties; Freight, Cartage and Express; and Machinery.

(*b*) Design a Check Register in accordance with form on page 308. The Company does all their banking with the Lynn Trust Company.

(*c*) Foot and rule books and summarize for posting.

(*d*) Set up Vouchers Payable account and prepare a schedule of unpaid vouchers to prove the balance correct as of September 30, 19—.

QUESTIONS FOR DISCUSSION

1. How do the purchases of a manufacturing business differ from those of a trading business?

2. The manager wishes to draw $25 for his personal use. Will it be necessary to prepare a voucher for this?

3. State in what way a voucher system provides a "check" upon the employees of a corporation.

4. What items in connection with a purchase are vouched for?

5. What is a voucher jacket and what information does it contain?

6. Are the details of invoices and expense bills shown on the voucher jacket?

7. When a voucher jacket has been approved, how is it disposed of?

8. Why is the former practice of having a form of receipt attached to the voucher jacket for the creditor to sign not generally used at present?

9. How may a voucher or receipt be secured from the creditor when the voucher jacket is not sent to him with the check?

10. In what respect does a voucher check differ from the ordinary check form?

11. What is a Voucher Register and how does it differ from an ordinary Purchases Journal?

12. When an Accounts Payable Ledger is not used with the Voucher Register, how is it possible to know which creditors have been paid?

13. How is the Voucher Register posted to the General Ledger?

14. How is the Voucher Register proved with the General Ledger?

15. Under the voucher system every expenditure has to go through exactly the same routine. Under what circumstances will this complicate matters?

16. Explain how purchase returns and allowances are handled under the voucher system.

17. What is done when part of a voucher is paid in cash?

18. How are payments by note recorded?

19. What effect does the voucher system have upon cash receipts and cash disbursements?

20. What is meant by a Check Register? Outline the columns necessary in this book.

21. Outline the various steps that are taken under the voucher system from the time an invoice is received until it is finally paid and the voucher filed with paid vouchers.

22. Name some of the advantages and disadvantages of the voucher system.

CHAPTER XXXVI

PETTY CASH PAYMENTS

Purpose of a Petty Cash System. — In every business there are always a number of small expenditures that are usually paid for in currency. The number and amount of such payments should, however, be kept at a minimum. These payments may be made from the general cash funds. When this is done a part of the cash receipts is not deposited but is held in the cash drawer for current use. This is a poor practice as all cash received should be deposited in the bank so that the total of the Cash Receipts Journal will agree with the total deposits as shown on the bank statement at the end of the month.

When currency payments are made from the general cash funds, they are entered in the Cash Payments Journal. This calls for numerous entries for small amounts and only a part of the cash payments are supported by checks. This makes it difficult to audit the accounts and keep an efficient check on currency payments. In order to take care of these properly only payments by check should be entered in the Cash Payments Journal, currency disbursements being recorded elsewhere.

When a Check Register such as illustrated in Chapter XXXV is used, only payments by check are entered therein and a separate record is necessary for currency disbursements. The best method of handling currency disbursements is to record them in a *Petty Cash Book* and to make the payments from a special fund known as a *petty cash fund*. This fund consists of an amount drawn from the cash in bank and kept in a separate cash drawer and placed in charge of a person known as the *petty cashier*. This person may be the regular cashier, a bookkeeper, information clerk, or any other clerk designated for the purpose. While there are a number of methods of administering the petty cash fund, only two of them will be explained in this chapter. They are known as the *imprest fund system*, or constant balance plan, and the *petty cash system*, or fluctuating balance plan.

Imprest Fund System. — This fund is established by drawing a check to the order of "petty cash" for the estimated amount that will be needed for currency disbursements for a given period, usually one month. The check is recorded in the Cash Payments Journal, debiting Imprest Cash Fund account.

If the voucher system is used, a voucher is made out for the amount of the fund and recorded; and the check is drawn and entered in the Check Register. The check is then cashed by the petty cashier and the currency placed in a *petty cash drawer*. After the fund has been established, no further debits and credits are made to the Imprest Cash Fund account, unless it is desired to increase or decrease the amount of the same permanently.

Under this plan all currency payments are recorded on petty cash vouchers. These vouchers, or receipts, should be signed by the one receiving the cash. They consist of blanks about 3″ × 5″, numbered consecutively and containing spaces for the date, amount, for what expended, name of account to be charged, and the signature of the one receiving the money.

CURRENCY VOUCHER **No.** 1

Date Jan. 1, 19--

Received from Central Mfg. Co.

$ 15.00 **For** Postage Stamps

Account Charged: Gen'l Admr. Expense--Postage

G. K. Wilson

Clerk

Illustration — Petty Cash Voucher

These vouchers are kept in the petty cash drawer until such time as the fund is replenished, when they are turned over to the cashier to be vouchered. The fund may be proved each day by adding to the cash in the drawer the total of the vouchers on hand, which should equal the original amount of the fund.

A record of the petty cash vouchers is made in a Petty Cash Book or on an analysis sheet. The petty cash record contains a column for receipts and a column for payments; it contains also distribution columns for the accounts to be charged, which should agree with the columns in the Cash Payments Journal or Voucher Register. Notice that the totals of the distribution columns of the Petty Cash Book illustrated on the following page agree with the amounts distributed from Voucher No. 111 on January 15, in the Voucher Register illustrated on pages 304 and 305.

PETTY CASH BOOK

DATE	PARTICULARS	P. Vr. No.	Receipts	Paym'ts	DISTRIBUTION OF EXPENSES				SUNDRIES		
					Factory Expense	Selling Expense	Delivery Expense	Admr. Expense	Name of Account	L. F.	Amt.
19—											
Jan. 1	Fund established by Ck #52		50 00								
1	Postage	1		15 00				15 00			
2	Soap and towels	2		3 50				3 50			
5	Advertising	3		4 50		4 50					
6	Oil for truck	4		1 50			1 50				
8	Emery paper, etc.	5		1 50	1 50						
10	Gasoline	6		4 00			4 00				
12	Cleaning	7		5 25	3 75			1 50			
12	Wages — Smith	8		5 00					Payroll		5 00
15	Express	9		2 25					Raw Mater.		2 25
15	Total Receipts		50 00		5 25	4 50	5 50	20 00			7 25
15	Total Payments			42 50							
15	Balance			7 50							
			50 00	50 00							
15	Balance		7 50								
15	Fund replenished by Ck #57		42 50								

Illustration — Petty Cash Book

The fund must always be replenished at the end of the month and at such other times as it becomes exhausted. A check is drawn for the amount expended, as shown by the petty cash record, which is supported by the petty cash vouchers or receipts. The various accounts indicated in the Petty Cash Book are then debited in the Cash Payments Journal or the Voucher Register. When the voucher system is used, the vouchers are summarized on a voucher jacket as shown on page 302 and an entry made in the Voucher Register crediting Vouchers Payable and debiting the various expense accounts in their respective columns. The check is entered in the Check Register debiting Vouchers Payable and crediting Cash. (See Voucher No. 111 in Voucher Register illustrated on page 304 and in Check Register on page 308). The check is then cashed and the currency placed in the petty cash drawer. The currency in the drawer should then equal the original amount of the fund. In the Petty Cash Book illustrated above, the currency in the petty cash drawer before replenishing amounted to $7.50. After cashing check #57 for $42.50 and placing the currency in the drawer the balance therein amounts to $50, the

original amount of the fund. The petty cash book under this plan is not a book of entry but simply a memo record for the purpose of analyzing the payments. No posting is done from this record.

Petty Cash System. — While the method of operation is very similar to that of the imprest system, there is a marked difference in the manner of recording the replenishing of the fund. The fund is established in exactly the same manner as the imprest fund, a check being drawn for the required amount and recorded in the same manner, the currency being placed in a separate cash drawer. A Petty Cash Book is kept with distribution columns the same as for the imprest fund and the payments recorded therein. While cash vouchers are very desirable their use under this plan is optional. Under the *imprest fund* system the cash vouchers are made the basis for original entries; yet no entries are posted from the Petty Cash Book to the ledger. Under the *petty cash* system the Petty Cash Book not only contains an analysis of the payments but it is also a book of original entry. When the fund needs to be replenished, a check is drawn for the desired amount, which is not necessarily for an amount equal to the previous expenditures as in the imprest fund. This check is recorded in the same manner as is the check when the fund is established, the Petty Cash Fund account being debited.

Under the *petty cash* plan, instead of charging expenses $42.50 at the time of replenishing the fund on January 15, as was done in replenishing the *imprest fund*, a check may be drawn for $50 and charged to Petty Cash Fund. As many checks as may be necessary are drawn during the month and recorded in the same manner as explained above. At the close of the month the Petty Cash Book columns are footed and ruled, and form the basis for a journal entry debiting the various expense accounts for the monthly expenditures and crediting Petty Cash Fund account. The balance of the Petty Cash Fund account in the ledger will then equal the amount of cash in the petty cash drawer.

For instance, in the Petty Cash Book illustrated on page 315 the following entry is made at the close of the month:

Factory Expense	$ 5.25	
Selling Expense	4.50	
Delivery Expense	5.50	
General Administrative Expense	20.00	
Payroll	5.00	
Raw Materials	2.25	
Petty Cash Fund		$42.50

Under the *petty cash* system only one distribution of expenses is required, and it is not necessary to replenish the fund at the end of the month, as there is still $7.50 on hand. As soon as this becomes exhausted a check may be drawn and cashed for any amount desired. Under the *imprest fund* system two distributions are necessary — one on the 15th to replenish the fund; the other on the 31st to replenish and to adjust the fund.

Methods Compared. — (1) Under the *petty cash* plan the Petty Cash Book is a book of original entry. Under the *imprest* plan, the Petty Cash Book is simply an analysis sheet, the entry being posted from the Cash Payments Journal or the Voucher Register.

(2) Under the *petty cash* plan, the Petty Cash Fund account in the ledger may fluctuate from month to month and consist of an odd amount. Under the *imprest* system, the Imprest Cash Fund account remains as established. The ledger accounts under the two methods appear as follows:

Imprest Cash Fund

19--											
Jan.	1	To establish		50	00						

Petty Cash Fund

19--						19--						
Jan.	1	To establish		50	00	Jan.	31	Payments		42	50
							31	Balance		7	50
				50	00					50	00
Feb.	1	Balance		7	50						

(3) Under the *petty cash* plan only one entry is made to the expense accounts and that at the close of the month. Under the *imprest* system, the expense accounts must be charged not only whenever the fund is replenished but also at the end of the month.

(4) Under the *petty cash* plan the use of currency vouchers is optional. Under the *imprest* system, currency vouchers for the expenditures form the basis for the issuance of the check that replenishes the fund. The vouchers are turned over to the cashier, who reimburses the petty cashier for their total amount.

Under both plans are found the following advantages:

(1) Petty cashier is held responsible for all currency disbursements. He may be required to secure a voucher or receipt for every payment.

(2) Cash Payments Journal is relieved of many detailed items.
(3) Not necessary to draw checks for small items.
(4) Simplifies the auditing of both cash receipts and cash payments.

EXERCISE 36-a

The Millis Manufacturing Company handles currency disbursements through an imprest fund system. It is estimated that $150 will be sufficient to meet such disbursements for one month. A check is drawn for this amount and charged through the Voucher Register to Imprest Cash Fund. A Petty Cash Book is provided with the following columns: Date, Particulars, Voucher No., Receipts, Payments, Postage, Office Supplies, Store Expenses, General Office Expenses, Carfares, Telephone and Telegrams, Sundry Debits, (Account and Amount). A signed voucher is procured to support every disbursement.

The following transactions took place during the month of July:

1 Check drawn for $150 to establish the fund. Paid for stamps, $15; ink, pens and pencils, $10; furniture polish and brooms for store, $7.50.
10 Paid for ice and water supply, $12; suppers, $2.50; telegrams, $4; postage, $7.
15 Paid for repairs to typewriter, $2.50; donation to welfare fund, $15; numbering machine for office, $9; rubber stamps, $3.50; postage, $3; store supplies, $7.75.
18 Paid for telegrams, $1.40; towel and soap supply, $7; postage, $10; express, $4; carfares, $2.50. Fund replenished.
20 Paid for cleaning and sweeping store, $8; carfares, $3; special clerical help, $20.
25 Paid for typewriter ribbons, $5; janitor's supplies, $7; revenue stamps, $12.
30 Paid for postage, $8; cleaning office, $4; telegrams, $4; carbon paper and filing index, $6.10. Fund replenished.

Required:

(*a*) Rule Petty Cash Book in accordance with particulars set forth above and record the transactions for the month of July.

(*b*) Foot and rule the columns at the time of replenishment of the fund and indicate the balance on hand.

(*c*) Prepare summary for entry in Voucher Register and indicate the amount of check to be drawn to replenish the fund.

EXERCISE 36-b

A company keeps a record of currency disbursements through an imprest cash fund which has been established at $25. At the end of the first month there is $2.50 in the cash drawer. A summary of the Petty Cash Book reveals the following expenditures for the month: cartons and wrapping paper, $7.40; cleaning windows, $4; postage, $8.60; supplies, $2.50. It is decided to increase the fund to $35.

Required:

Outline the procedure for handling the fund at the end of the month and set up the entries necessary to adjust the account.

EXERCISE 36-c

A company using the petty cash fund method of handling petty cash disbursements classifies currency disbursements as follows: Office Expenses and Supplies; Postage, Express and Parcel Post; Stationery and Printing; Traveling Expenses; Telephone and Telegrams; Cleaning; and Miscellaneous Expenses. The Petty Cash Book is ruled with columns for Date, Particulars, Voucher No., Receipts, Payments, and expense accounts as indicated above. The following transactions took place during the month of October.

1 Drew check No. 10 for $75 to be used as a petty cash fund from which currency disbursements are to be made. Paid $3.40 for a petty cash box, in which to keep the petty cash fund, and a petty cash book. Paid for postage stamps, $15; parcel post, $1.25; express, $1.89; suppers, $2; cleaning, $5.

4 Paid for postage, $2.50; office supplies, 75 cents; car fares, 60 cents; stationery, $10.

8 Paid for express and parcel post, $15; stamp pads for office, $1; cleaning windows, $4.50; telegram, 35 cents.

17 Drew check No. 26 for $75 to replenish fund. Paid for postage stamps, $5; telephone, $8.50; brooms, soap and dusters, $5.25.

22 Paid for traveling expenses, $10; parcel post, $2.50; cleaning, $3.50; express, 50 cents.

28 Paid for stamped envelopes, $3.30; office supplies, $4; express and parcel post, $2.75; part-time clerical help, $12.

31 Paid for repairing office desk, $5; telegrams, 70 cents; parcel post, $2.30; postage, $2.

Required:

(*a*) Rule columns for a Petty Cash Book as indicated above and record the above transactions therein.

(*b*) Foot and rule columns showing balance in petty cash fund.

(*c*) Prepare a summary for posting to the General Ledger.

EXERCISE 36-d

A company records all its currency disbursements in a Petty Cash Book. The following is a summary of the items recorded in the Petty Cash Book during the month of June, 19—.

General Office Expenses	$ 85.00
Telephone and Telegrams	14.95
Stationery and Postage	150.00
Advertising	42.50
Cleaning and Supplies	25.00
Traveling Expenses	60.00
Donations	25.00
Merchandise Refunds	10.00

Required:

Explain how the above items would be handled during the month and show entries that would be made at the close of the month under (a) petty cash fund, (b) imprest cash fund.

QUESTIONS FOR DISCUSSION

1. State why payments of actual cash should be avoided as much as possible.
2. In what particular does the use of a *petty cash* system make it easier to audit the books?
3. Who handles the petty cash in an office? Does such a person have other duties?
4. Explain how the *imprest* fund is established.
5. What is meant by a currency voucher and what information does it contain?
6. What disposition is made of the currency vouchers, and how may they be used to account for the petty cash disbursed?
7. What is the purpose of the petty cash book under the *imprest* system?
8. When must the *imprest* fund be replenished and what is the procedure?
9. How does the procedure for establishing the *petty cash* system differ from that of the *imprest fund* system?
10. Need there be any difference in the form of the Petty Cash Book under the two systems?
11. How is the Petty Cash account affected under the two systems when the petty cash is replenished during the month? At the end of the month?
12. How do the ledger accounts differ under the two methods?
13. Compare the *imprest fund* and *petty cash fund* systems and state in detail how they differ?
14. Under which of the above systems is the Petty Cash Book a book of original entry, or posting medium?

SUMMARY OF CHAPTERS XXXV–XXXVI

A voucher system is a special type of purchase record used in a manufacturing business on account of the great variety of purchases, and in order to fix responsibility for action on the part of employees. It combines the functions of the Purchases Journal and the Accounts Payable Ledger, and provides that no funds can be paid out without securing proper authority. In its operation a voucher jacket, voucher check, and Voucher Register are used. The voucher jacket contains an abstract of the creditor's invoice on the front and a distribution of the charge on the back. The voucher check is an ordinary check with the number of the voucher and a notation of the charge so that it can be filed with the paid voucher when returned by the bank. The Voucher Register contains a record of all voucher jackets with columns for the various charges and details as to payment.

The voucher system does not work well when there are purchase returns and allowances, partial payments, and payments by note. Such items require special entries. A Check Register is used with a Voucher Register when all payments are made by check. This book contains only a record of the payment of the vouchers with all discounts that may be taken.

Currency disbursements are handled through a petty cash system when a Check Register is used. Such items are recorded in a Petty Cash Book which contains analysis columns for the various expenses. The cash is paid from a petty cash drawer in charge of a petty cashier.

Two methods of handling petty cash are used; imprest fund system and petty cash fund system. They are similar in the manner of establishment and operation, except when it is desired to replenish the fund. The charges for expenses from the Petty Cash Book, when the fund is replenished, are made through the Voucher Register under the imprest fund, and the amount in the ledger remains *fixed*. They are made directly from the Petty Cash Book under the petty cash fund system and the amount in the ledger *varies*. Therefore, the petty cash drawer must be replenished at the end of the month under the imprest fund system. This is not necessary under the petty cash fund method. Petty cash vouchers may be secured for all payments under both methods.

BUSINESS PRACTICE SET NO. 4

A Manufacturing Set in which the voucher system is employed may be worked at this point at the option of the teacher. Using the vouchers, blank forms and record books furnished for the purpose, the pupil writes up the set in accordance with the instruction sheet provided with the set.

The purpose of the set is to afford practice in keeping a set of books for a corporation in the manufacturing business, thus reviewing the corporate and manufacturing procedure presented in the text.

SINGLE ENTRY

CHAPTER XXXVII

RECORDS USED

Single Entry Bookkeeping Defined. — The term "Single Entry" implies that each business transaction has only a single debit or credit effect upon the assets, liabilities and capital of a business. The principle of equality of debits and credits with its twofold effect upon the ledger accounts as applied in the double entry system is not present. In its simplest form accounts are kept only with customers, creditors, and the proprietor, and only those transactions are posted that affect these accounts. A detailed record is kept of the cash receipts and payments and accounts are sometimes kept with such items as notes receivable, notes payable, properties and equipment, and in a few cases with expenses and merchandise. Where this is done it is no longer purely single entry but approaches the double entry form. In practice any incomplete method of keeping accounts not in double entry form is referred to as single entry.

Books and Records Used. — The journal and the ledger are the principal books used. A cash book or some record of cash receipts and payments is also usually found. It is not unusual to find the sales journal, purchases journal, note registers, etc., used both as books of entry and as auxiliary books. The forms of these records do not differ materially from those used in double entry. Many single entry systems, as a matter of fact, are double entry systems that are incomplete and out of balance because of poor bookkeeping.

The following transactions are used to illustrate the method of operating a simple form of single entry journal and cash book:

November 1, 19— Arthur Whitefield invested in business: cash in bank, $2,500; stock of goods on hand, $1,800; office equipment, $200.

2 Paid for rent and sundry expenses in cash, $75.

3 Bought of W. T. French, on account, 500 bu. wheat at $1.40 and 200 bu. corn at 75¢.

4 Sold John Waters, on account, 100 bu. wheat at $1.50 and 50 bu. corn at 80¢.

5 Gave W. T. French a 10-day note for $500 to apply on account.

5 Bought of C. T. Craven 300 bu. wheat at $1.30, terms 2/10 n/30.

6 Received check from John Waters for $175 after allowing claim of $15 for shortage in shipment of Nov. 4.

15 Paid note for $500 due W. T. French in cash. Paid office salaries, $100.

15 Paid Craven's bill of Nov. 5 less 2% discount.

SINGLE ENTRY JOURNAL

November 1, 19--

	Arthur Whitefield, Capital	Cr.					
	Began business with an investment of Cash in Bank			2500	00		
	Stock of goods on hand			1800	00		
	Office Equipment			200	00	4500	00
3	W. T. French	Cr.					
	Purchased on account						
	500 bu. wheat at $1.40			700	00		
	200 bu. corn at .75			150	00	850	00
4	John Waters	Dr.					
	Sold him on account						
	100 bu. wheat at $1.50			150	00		
	50 bu. corn at .80			40	00	190	00
5	W. T. French	Dr.					
	Issued to him 10-day note to apply on account					500	00
5	C. T. Craven	Cr.					
	Purchased 2/10 n/30						
	300 bu. wheat at $1.30					390	00
6	John Waters	Cr.					
	Allowed him credit for shortage in shipment of November 4.					15	00

In the first transaction the proprietor's capital account is the only personal account affected. He is, therefore, credited with the total investment, there being no debits. In the purchases of November 3 and 5, W. T. French and C. T. Craven are credited, while in the sale of November 4 John Waters is debited. No debit or credit is made for the merchandise in any of these transactions. W. T. French is charged with the note issued to him on November 5 but no record of the note is made in the ledger. John Waters is credited for allowance on November 6 but no debit is made. The journalizing is done according to double entry rules but only those items are debited or credited which

affect personal accounts. For instance, in double entry the first transaction would appear as follows:

✓ Cash	$2,500.00	
Merchandise Inventory	1,800.00	
Office Equipment	200.00	
Arthur Whitefield, Capital		$4,500.00

In single entry only the credit to the proprietor's account of $4,500 is made.

In the form of journal shown on page 323 the left-hand money column is used for items and the right-hand column for the totals which constitute the debits and credits. As the debits and credits appear in the same column the abbreviations "Dr." and "Cr." appear after the name of the account so as to indicate the posting. Sometimes the debits are placed in the left-hand column and the credits in the right-hand column, in which case the abbreviations are omitted.

A cash book may be used in connection with the journal for recording cash receipts and cash payments. A single-entry form of cash book was formerly used, consisting of a single journal page with receipts in the left-hand money column and payments in the right-hand column; the customary form is the ordinary double-page book used in double entry. In some instances a columnar book is used. The following illustration shows a form of cash book suitable for use when cash discounts are allowed.

CASH RECEIPTS

Date	L. F.	Particulars	Amount Posted	Net Cash
19--				
Nov. 1	✓	Arthur Whitefield--Capital Invest.		2500 00
6		John Waters--Ck.in full of account	175 00	175 00
		Total	175 00	2675 00

CASH PAYMENTS

Date	L. F.	Particulars	Amount Posted	Net Cash
19--				
Nov. 2	✓	Paid rent and sundry expenses		75 00
15	✓	Paid note due W. T. French		500 00
15	✓	Paid office salaries to date		100 00
17		C. T. Craven--Bill 5th less 2%	390 00	382 20
17	✓	Balance on hand		1617 80
		Total	390 00	2675 00

No attempt is made in foregoing form of cash record to place the names of the accounts in a debit or credit column. The items to be posted to the ledger are shown in the Amount Posted columns. No record is made of the cash discount. In many instances the regular double entry form of cash book is used but no attempt is made to classify the expenses.

Proof of Posting. — There is no special ledger form for single entry bookkeeping. Aside from the fact that it contains no nominal accounts and only the real accounts with customers, creditors, and proprietor, it is the same as the double entry ledger and the manner of posting to the accounts contained therein is the same as for double entry.

As no attempt is made to keep an equality of debits and credits a trial balance cannot be taken from the ledger. The correctness of the posting is determined by *proving the posting*. This is done by finding the balances of all the accounts in the ledger in the same manner as in double entry. These balances are listed in debit and credit columns and the difference between the total debits and total credits found. The amounts posted from the various books are then totaled and their difference found, which should agree with the difference between the debit and credit balances of the accounts in the ledger as explained above. Another method is to total the debits of all ledger accounts and compare this amount with the total of all debit items in the books of original entry. The credits are proved in the same way. This work is facilitated if the debits and credits appear in separate columns in the journals. The form of proof of posting may be set up as follows.

Proof of Single Entry Posting

Ledger Balances	Debits	Credits
Horace Thacker, Capital		$4,000.00
George Landry	$ 450.00	
Thomas Ross	1,250.00	
G. W. Colpitts	400.00	
A. B. Collins		850.00
Stewart Mfg. Co.		350.00
Difference	3,100.00	
	$5,200.00	$5,200.00
Original Entry Books		
Journal totals	$ 500.00	$1,800.00
Cash credited to accounts		1,750.00
Cash debited to accounts	1,350.00	
Sales journal debits	2,350.00	
Purchases journal credits		3,750.00
Difference	3,100.00	
	$7,300.00	$7,300.00

If the books are well kept it is possible to set up a trial balance from the ledger and the books of original entry. Temporary accounts can be set up for sales, purchases, expenses, etc., the total amount of which should account for the difference between the sides of the ledger accounts as shown above.

EXERCISE 37-a

George Bunker, 105 Newbury Street, Boston, commences a book and stationery business on November 1, 19— with the following assets and liabilities: Cash in bank, $2,400; Accounts Receivable, $1,542.40; Notes Receivable, $750; Store Building, $25,000; Store Equipment, $3,540; Office Equipment, $642.25; Accounts Payable, $350; Notes Payable, $500.

Required:

Prepare the opening journal entry

(*a*) under the Single Entry method.

(*b*) under the Double Entry method.

EXERCISE 37-b

July 1, 19— A. J. Sullivan began business this day investing: Cash, $2,200; J. Brown's note at 30 days from to-day, $200. He owes Wallis & Co. on 60-day note, $450.

2 Paid for books and stationery, $50; rent for 2 months in advance, $150.

3 Bought from D. A. Murray merchandise amounting to $625. Accepted his draft at 30 days with interest at 6% for the amount less 2%.

4 Sold C. T. Harris merchandise to the amount of $175 on his 15-day interest bearing note.

5 Mr. Sullivan withdrew for private use $50 in cash. Paid bookkeeper for his month's wages, $90.

9 Sold James Walton on account merchandise amounting to $350; terms 2/10 n/30.

10 Bought of Lester and Co. on account merchandise to the amount of $225.

12 Prepaid acceptance of Murray's draft less discount. Paid proceeds in cash.

14 Sold H. A. Wolff $250 worth of merchandise. Drew a draft on him at 30 days from date and mailed to him for acceptance. Mr. Sullivan replaced the $50 withdrawn on the fifth.

16 Paid Lester and Co. $175 in cash to apply on account.

19 Received check from C. T. Harris covering his note and interest. James Walton sent his check for bill of the 9th according to terms.

25 Bought furniture for office, $180. Gave 30-day note in payment. Sold Meeker & Co. merchandise on account, $450.

28 Draft drawn on H. A. Wolff was returned bearing his acceptance.

31 J. Brown paid his note and interest by check.

31 Sold Wilson and Son merchandise on account, $260.

Required:

(*a*) Prepare a single entry set of books for Mr. Sullivan consisting of a journal, cash book and ledger. Follow the forms outlined in this chapter.

(*b*) Post to the ledger (5 ledger accounts to a page) and prepare a proof of posting.

QUESTIONS FOR DISCUSSION

1. What is the significance of the word "single" as applied to single entry bookkeeping?
2. In what particulars is this system indefinite and difficult to define?
3. What accounts are usually kept under this system?
4. Name the books and records in common use and state in what particular they differ from double entry records.
5. Outline two ways of recording the amounts in the single entry journal.
6. Why is it not possible to obtain a trial balance from a single entry ledger?
7. In what way is the ruling of the single entry ledger different from that of double entry?
8. Why do many single entry sets of books resemble double entry sets in so many ways?
9. Explain how the correctness of the books may be proved in single entry.
10. How may the journal and cash book be arranged to facilitate the proof of posting in single entry?
11. Under what circumstances would it be possible to construct a trial balance from single entry books?
12. State what information may be obtained from double entry books that cannot be obtained from a set of books kept under the single entry method.
13. Explain the "proof of posting" method of testing the accuracy of a single entry ledger.
14. Name the types of business for which a single entry set of books would be most adaptable.

CHAPTER XXXVIII

FINANCIAL STATEMENTS IN SINGLE ENTRY

Finding Profit or Loss from Single Entry. — In double entry bookkeeping the adjusted trial balance forms the basis for the preparation of the financial statements which show the profit or loss for the year with a complete analysis of the same. In single entry the ledger contains only a part of the assets and liabilities of the business and no nominal accounts, so that a trial balance is not possible, and about the only way the progress of the business may be determined is by comparing the net assets at the beginning of the period with the net assets at the end of the period, taking into consideration additional investments or withdrawals of capital during the year.

For instance, if the net assets on January 1 amount to $20,000 and on December 31 of the same year they amount to $25,000, there is an increase of $5,000. If there have been no capital additions or deductions during the year this increase in net worth represents profit. If, however, the proprietor has drawn out of the business for his personal use during the year $2,500 the earnings of the business must have been $7,500. On the other hand, if he drew out nothing but made an additional investment of $2,000 during the year the business earned but $3,000. If he both withdrew and invested the amounts as stated the profit for the year would have been $5,500 ($5,000 plus $2,500 minus $2,000).

Form of Financial Statement. — Since profits or losses in single entry are found by comparing the net worth of the business at the beginning and end of the period, a form of statement must be prepared that will give such results. This statement is known as a Statement of Assets and Liabilities and is made up as follows:

(1) Ascertain the value of all properties and equipment on hand by taking a physical inventory and having it appraised.

(2) List all other assets owned by the business:

- (*a*) Cash as per cash book and bank account
- (*b*) Notes receivable as per note register and notes on hand
- (*c*) Accounts Receivable as per ledger
- (*d*) Accrued and prepaid items.

(3) List all liabilities and claims against the business:

(*a*) Notes payable as per note register
(*b*) Accounts payable as per ledger
(*c*) All outstanding expense bills
(*d*) Accrued and deferred items.

(4) Total the assets and liabilities and find their difference, which is the net worth at the end of the period.

(5) Compare the net worth at the end of the period with the net worth or investment at the beginning of the period and find the increase or decrease.

(6) To the increase in net worth add any drawings and deduct any additional investments, and the result represents the profit for the period.

To the decrease in net worth add additional investments and deduct drawings to find profit or loss.

The following is a form of single entry financial statement made in accordance with the above outline assuming that there are no drawings or additional investments.

Horace Thacker
Statement of Assets and Liabilities, December 31, 19--

Assets			
Cash		$1,250.00	
Notes Receivable		750.00	
Accounts Receivable:			
George Landry	$ 450.00		
Thomas Ross	1,250.00		
C. W. Colpitts	400.00	2,100.00	
Merchandise inventory		2,600.00	
Office Equipment		650.00	
Delivery Equipment		1,200.00	
Total Assets			$8,550.00
Liabilities			
Notes Payable		$1,275.00	
Accounts Payable:			
A. B. Collins	$850.00		
Stewart Mfg. Co.	350.00	1,200.00	
Total Liabilities			2,475.00
Net Worth, December 31, 1926			$6,075.00
Net Worth, January 1, 1926, deducted			4,000.00
Net Profit for the Year			$2,075.00

Assuming that Mr. Thacker's personal drawings during the year amounted to $500 and that in order to provide working capital he increased his investment during the year $1,000, the following statement is made to find the real net earnings of the business.

Analysis of Increase in Net Worth
for Year Ending December 31, 1926

Increase in Net Worth	$2,075.00
Add--Proprietor's Personal Drawings	500.00
Total	$2,575.00
Deduct--Additional Investment	1,000.00
Net Profit for the Year	$1,575.00

Complete Profit and Loss Statement from Single Entry Books. — It is sometimes desired that a profit and loss statement be prepared for the purpose of analyzing the profit or loss as shown by the statement of assets and liabilities taken from single entry records. This can be done with reasonable accuracy, providing the books have been well kept. For instance, in a set of books where sales, purchases and cash items are kept in separate books, the sales may be taken from the sales book and the purchases from the purchases book. The expenses and income may be found by analyzing the cash receipts and cash payments. The larger items of expense may be grouped quite easily and the others included under Sundry Expenses. The inventories may be compared with those of the previous period and where none has been taken a reasonable amount may be allowed for depreciation. The following is a profit and loss statement, consisting of items taken from Thacker's books of entry:

Horace Thacker
Profit and Loss Statement
for the Year Ending, December 31, 1926

Net Sales for the Year		$20,087.00
Deduct--Cost of Goods Sold:		
Inventory at January 1, 1926	$ 2,200.00	
Net Purchases for the Year	15,200.00	
Total Cost of Goods	$17,400.00	
Deduct--Inventory, Dec. 31, 1926	2,600.00	14,800.00
Gross Profit on Sales		$ 5,287.00
Deduct--Operating Expenses:		
Salaries and Wages	$ 2,460.00	
Rent	1,000.00	
Depreciation of Office Equipment	60.00	
Depreciation of Delivery Equipment	250.00	3,770.00
Net Profit from Operations		$ 1,517.00
Add--Other Income:		
Discount on Purchases	$ 46.00	
Interest Earned	12.00	58.00
Net Profit for the Year		$ 1,575.00

Closing the Ledger. — As there are no expense and income accounts in the ledger the only account to be closed is that of the proprietor. A journal entry may be set up to credit the capital account for the profit or debit it for the loss, as the case may be. The entry for Mr. Thacker in the above illustration is as follows:

December 31, 1926

Horace Thacker, Capital Cr. $1,575.00

To credit the proprietor's account for the net profit for the year.

This entry is then posted to the capital account which is ruled and the balance brought down for the next period. Mr. Thacker's account appears as follows after posting the above entry:

Horace Thacker, Capital

1926					1926				
July	1	Cash Drawn		500 00	Jan.	1	Balance	4000	00
Dec.	31	Balance		6075 00	Nov.	1	Add'l Invest.	1000	00
					Dec.	31	Net Profit	1575	00
				6575 00				6575	00
					1927				
					Jan.	1	Balance	6075	00

Changing from Single to Double Entry. - The bookkeeper's chief interest in single entry should be to be able to change the same to a double entry basis. There is no single entry system so satisfactory but that a double entry system would be more satisfactory. From the foregoing it is seen that the single entry ledger contains accounts with customers, creditors and the proprietor only, all expense, property and other impersonal accounts being omitted. In order to change the books from single to double entry, it is necessary to make such entries in the ledger as will cause it to exhibit all of the assets and liabilities of the business. In addition to this such expense and income accounts as may be needed must be added. The original entry books will very often need no change at all except that items should be recorded in such form that they may all be posted to the proper accounts in the ledger. The steps necessary to change from single to double entry may be summarized as follows:

1. Prepare a statement of assets and liabilities showing net worth.
2. Compare net worth at end of period with net worth at beginning, taking into consideration drawings and additional investments, and find profit or loss for the period.

3. Credit or debit the proprietor for the profit or loss for the period and balance the capital account.
4. Prepare a journal entry debiting all assets and crediting all liabilities as shown by the statement of assets and liabilities, and credit the proprietor for the difference or net worth.
5. If new ledger is to be used open an account for each item in the journal entry and post as usual.
6. If the same ledger is to be continued place a check mark in front of the personal accounts and any others already in the ledger, as they should not be posted. Then post those not checked, writing "Inventory" as explanation in the new accounts opened in the ledger.
7. Take a trial balance of the ledger to prove that the accounts are in balance.
8. Plan nominal accounts and arrange their location in the ledger.

Assume that Horace Thacker in the foregoing illustration desires to change his books to double entry. The first three steps have been taken. The journal entry prepared from the statement on page 329 is as follows:

	Cash	1250 00	
	Notes Receivable	750 00	
✓	George Landry	450 00	
✓	Thomas Ross	1250 00	
✓	C. W. Colpitts	400 00	
	Merchandise Inventory	2600 00	
	Office Equipment	650 00	
	Delivery Equipment	1200 00	
	Notes Payable		1275 00
✓	A. B. Collins		850 00
✓	Stewart Mfg. Co.		350 00
✓	Horace Thacker, Capital		6075 00
	This entry made to change books from single to double entry.		

Assuming that the same ledger is to be used, the accounts already in the ledger are checked so that they will not be posted twice. All other accounts are posted as usual. If a new ledger is to be used all items will be posted. The ledger should now be in balance and to prove that it is a trial balance should be taken.

The old ledger may be closed by means of a journal entry debiting the accounts showing credit balances and crediting the accounts showing debit balances. If in changing to the new books it is desired to keep separate ledgers

for customers and creditors, then controlling accounts for Accounts Receivable and Accounts Payable will be opened in the General Ledger and the detailed accounts opened in the subsidiary ledgers.

Comparison of Single and Double Entry. — 1. The single entry ledger usually contains only accounts with customers, creditors and the proprietor; property, expense and income accounts being omitted. The double entry ledger shows the classified results of all transactions and contains all the asset, liability, expense, income and capital accounts.

2. In ordinary single entry the bookkeeper has no ready check on his accuracy in posting, footing his ledger accounts, and preparing his financial statements. In double entry he has a trial balance for proof of posting, for proving the footings of ledger accounts and for use as a basis for the preparation of the financial statements.

3. In single entry a statement of assets and liabilities may be prepared, but part of the information contained therein must be secured outside the books, while in double entry the financial statement is prepared from and proves with the books.

4. In single entry a statement of profit and loss must be figured from many sources, with no proof of accuracy and very often with only approximate results, while in double entry the profit and loss statement is prepared from the books and proves with the balance sheet.

5. In single entry the sources of profits and losses cannot be ascertained with any degree of accuracy, while in double entry the books show the sources of all profits and losses in detail.

6. In single entry statistical information and cost data to guide the proprietor in the management of his business is often lacking, while in double entry all this is available from the books.

7. Finally, double entry is suitable for all kinds of business, large or small, and is little or no more work than single entry, which is suitable only for retail concerns having many customers, or for professional men.

EXERCISE 38-a

On January 1, 1926 the net worth of Geo. B. Franklin, who keeps his books by single entry, amounts to $12,246.45. During the year he withdrew at various times sums amounting to $1,542.50. On November 1, 1926 he made an additional investment of $3,000. On December 31, 1926 his net worth was $15,785.20.

Required:

Prepare a statement showing net profit or net loss for the year.

EXERCISE 38-b

On July 1, 1927 Thomas Walker began business with the following assets: Cash in bank, $8,500; stock of goods, $4,620; equipment, $2,400. During the next six months he withdrew for personal use $2,450. On December 31, 1927 he has the following assets and liabilities: Cash in bank, $9,430; stock of goods, $6,235.40; equipment, $2,200; due from customers, $5,423; note against Geo. Cuyler for $1,000. He owes creditors $1,569.10, and a note at the bank for $2,500.

Required:

Prepare a statement showing the net worth of the business at the end of the year together with profit or loss for the period.

EXERCISE 38-c

Referring to the solution to Exercise 37-b on page 326, an appraisal of the assets not entered on the books shows the following: Merchandise inventory, $345.25; prepaid rent, $75; books and stationery, $25; office furniture, $170.

Required:

(*a*) Prepare a statement of assets and liabilities as of July 31 showing the condition of the business and the profit or loss for the period.

(*b*) Make the entry in the single entry journal to transfer profit or loss to the capital account.

(*c*) Prepare the entry necessary to change the books to a double entry basis assuming that the old books are to be used.

EXERCISE 38-d

C. Atwood and J. A. Carpenter are engaged in the lumber business and keep their books by single entry. The ledger shows the following information: Atwood, Capital January 1, 19—, $7,250; Carpenter, $9,620; Atwood drawings to December 31, 19—, $3,250; Carpenter, $4,325. Customers' accounts: J. Brown, $852; Thos. Waite, $1,435; James Willets, $3,245; A. B. Smith, $378. Creditors' accounts: Downey Lumber Co., $2,345; Roberts and Payne, $523; Jordan Bros., $1,560. The following information is found regarding assets and liabilities not in the ledger: Notes on hand, $458, on which $6.50 interest has accrued; a note owing to the Waveland Trust Co. for $2,300 dated November 15 for 90 days with interest at 6%; inventory of material and supplies, $2,348; office equipment on hand that cost $520 and has depreciated 10%; delivery truck costing $1,800, depreciation 20%. The firm owns bonds worth $1,200; a mortgage receivable for $2,000; real estate valued at $35,000 against which there is a first mortgage of $15,000, second mortgage of $5,000, and third mortgage of $2,500. The bank statement shows $151.98 in bank. There is $4 99 petty cash in the office; office supplies on hand worth $25.40; and advertising matter costing $65. Insurance prepaid amounts to $75.

Required:

(*a*) Prepare a statement of assets and liabilities showing the net worth on December 31, 19— together with a supplementary statement showing the profit or loss for the year. Profits are shared Atwood one-third and Carpenter two-thirds.

(*b*) Prepare entries to adjust ledger accounts of the partners.

(*c*) Set up T ledger accounts showing details of the partners' accounts.

(*d*) Prepare entries to change books to double entry assuming that a new set of books is to be used.

(*e*) Suggest a list of nominal accounts that may be used under the double entry system.

EXERCISE 38-e

M. T. Wallace has been keeping his books by single entry but desires to have them placed on a double entry basis. The following data is submitted concerning the business for the year ending June 30, 19—:

Investment, $25,000; drawings, $2,650; cash in bank as per bank statement, $17,075; due from customers, $7,230; due to creditors, $7,625; note due the bank, $3,500; notes on hand, $4,895; land and buildings owned, $16,700; mortgage owing on land and buildings, $12,500; interest accrued on mortgage, $375; total purchases for the year, $42,840; total sales for the year, $46,285; stock of goods on hand, $7,150; insurance premiums unexpired, $230; general expenses paid (including interest and insurance), $3,520; expense bills due and unpaid, $150; interest prepaid on the note at the bank, $45.

Required:

(*a*) Prepare statement of assets and liabilities showing net worth and profit or loss for the year.

(*b*) Prepare a detailed profit and loss statement in report form.

(*c*) Adjust capital account.

(*d*) Prepare journal entry to change books to double entry basis.

EXERCISE 38-f

November 1, 19— John Grover commences a retail hardware business. His capital is made up as follows:

Cash, $2,300.

Inventory, $4,000, for which he still owes Baker Bros. $1,200.

Real Estate, $8,000 (land, $1,200; buildings, $6,800).

There is a mortgage of $5,000 payable in three years from October 15, 19—, interest at 6% payable semiannually.

The books consist of a journal, cash book, and ledger. They are to be kept by single entry.

2 Buys merchandise from C. L. Hines & Company on account, $900.

3 Sells merchandise to Myron Cole on account, $375.

5 Cash sales to date, $197.16.
5 Sends C. L. Hines & Company a 60-day 6% interest-bearing note for $500.
7 Sells merchandise to Lawrence Ross for cash, $100.50.
9 Purchases merchandise on account from Holmes & Walker, $500.
9 Pays clerks' salaries, $40.
10 Mr. Cole sends check for $200 to apply on account.
11 Purchases 4 tons of coal at $16 a ton.
12 Pays stationery bill, $19.80; freight, $7.65; light bill, $6.34.
14 Cash sales to date, $314.90.
16 Buys merchandise on account from Warren Miller & Company, $700.
17 Pays clerks' salaries, $40.
19 Mr. Grover withdraws cash for personal use, $75.
20 Sends Warren Miller & Company a check on account, $500, and 30-day note with interest at 6% for the balance.
21 Receives check in full of account from Myron Cole.
23 Sells merchandise to Thomas Osgood on account, $500.
24 Receives a 30-day note from Thomas Osgood, $300.
24 Cash Sales to date, $410.13.
25 Pays clerks' salaries, $55.
27 Discounts at 6% Thomas Osgood's note received on November 24.
29 Mr. Osgood returns goods received in a damaged condition, $32.
30 Pays cash as follows: telephone, $7.20; clerks' salaries, $40; taxes, $62.10.

Supplementary data:

Value of merchandise on hand, $3,619.43.
Estimated depreciation of buildings, 2% annually.
Supplies on hand valued at $12.50.
Wages earned but not paid, $25.

Required:

(*a*) Record the above transactions in the journal and cash book.

(*b*) Post to the ledger (5 accounts to a page) and prepare proof of posting.

(*c*) Prepare a statement showing net worth November 30 together with the profit or loss for the month.

(*d*) Make entry in journal to adjust Mr. Grover's capital account.

(*e*) Set up journal entry to change books from single to double entry, same books to be used.

QUESTIONS FOR DISCUSSION

1. Inasmuch as a trial balance is not possible under single entry what is used as a basis for the financial statements?

2. In what way do drawings and additional investments affect the results as shown by the statement of assets and liabilities?

3. Outline the procedure for gathering the data from which the financial statement is prepared and state the sources of such information.

4. In what way, if any, is the profit or loss of the business recorded in the ledger at the end of the fiscal period?

5. Is it usually possible to construct a complete profit and loss statement under the single entry plan? Outline the procedure.

6. As there are no expense accounts in the ledger how is the amount of expense for the period arrived at?

7. Should a bookkeeper encourage the use of single entry bookkeeping?

8. Outline steps necessary to change books from single entry to double entry.

9. In making the change from single to double entry what adjustments are necessary in the form of the books?

10. Does it make any difference in the bookkeeping procedure whether the old books are to be continued or new ones used for the double entry? Explain.

11. State some of the differences between single entry and double entry bookkeeping.

12. What is your conclusion as to the advantages of the double entry?

SUMMARY OF CHAPTERS XXXVII–XXXVIII

In single entry, accounts are usually kept in the ledger only with customers and creditors and the proprietor. The same type of journal and ledger is used as for double entry but only the debit or credit effect upon the accounts used is recorded. A complete set of journals may be kept. A trial balance is not possible under this system. Posting is proved by totaling the debits and credits posted from the journals to the ledger and comparing their difference with the difference between the total debits and credits in the ledger.

The financial condition of the business is found by preparing a statement of assets and liabilities and finding the net worth at the close of the period. Those assets and liabilities not appearing in the books are inventoried and appraised in order to determine the amounts to be used in the statement. The net worth at the end of the year is compared with that at the beginning of the year in order to determine the profit or loss. The increase is a profit and the decrease a loss provided there have been no withdrawals or additional investments. A detailed profit and loss statement is seldom possible under this method of accounting.

The books may be changed to a double entry basis by debiting the assets and crediting the liabilities appearing in the statement and crediting the proprietor for the difference. Those items not in the ledger are posted and a classification of expense accounts decided upon, after which the system is operated on the double entry basis.

SPECIAL SALES METHODS

CHAPTER XXXIX

CONSIGNMENTS

Nature and Purpose. — A consignment is a shipment of goods by the owner to another to be sold for the account of the owner. The owner and shipper of the goods is known as the *consignor;* the one receiving the goods to be sold is known as the *consignee.* The one selling the goods is also variously known as a *commission merchant, factor* or *agent.* The compensation of the consignee for handling the goods for the consignor is usually a certain percentage of the selling price and is known as a *commission.*

A consignment differs from a sale in that the ownership of the goods does not pass to the consignee but remains with the consignor until the goods are sold. Therefore, the consignee is not obliged to pay for the goods until disposed of, and he makes no profit from the sale other than his commission. The expenses of handling the goods are borne by the consignor and, together with the

Invoice No. 418

INVOICE OF SHIPMENT

Cleveland, Ohio September 1 19--

Invoice of Mdse. shipped to

M T. M. Price & Company

70 Broad Street, Boston, Mass.

Via American Express Company

To be sold on account and risk of

G. T. HAINES AND COMPANY
Forwarders and Commission Merchants

Remit proceeds by check

State No. of invoice in rendering account sales.

		300 bu. Peaches				

Illustration — Shipping Invoice

commission for selling, are usually deducted from the sales price by the consignee when he renders his account to the shipper of the goods.

Perishable goods and goods that fluctuate greatly in price are often shipped on a consignment basis, because the consignee is not willing to take the risk of buying them outright. This method is often resorted to for the purpose of introducing new products or for testing out new markets; in both of which cases the consignee does not wish to take the risk of tying up capital in goods for which there may be no demand. The consignment is sometimes used by the consignor also as a credit measure so that he may retain title to the goods in case the consignee becomes financially involved.

Shipping Invoice. — When goods are shipped on consignment, instead of rendering a bill to the consignee as would be done in the case of a regular sale, a *shipping invoice* is made out describing the goods shipped and giving such

No. 1210

ACCOUNT SALES

Office of T. M. PRICE AND COMPANY
Forwarders and Commission Merchants

Boston, Mass., September 20 19--

Account Sales of Invoice No. 418 received September 3 19--
from G. T. Haines & Co. of Cleveland, to be sold on sole account and risk.

19--							
		Received					
Sept.	3	300 bu. Peaches					
		Sales					
Sept.	10	100 bu. Peaches	@ $3.50	350	00		
	15	200 " "	@ $4.00	800	00	1150	00
		Charges					
		Freight and Express		43	50		
		Storage		15	00		
		Insurance					
		Commission and Guaranty 5%		57	50	116	00
		Net Proceeds by Check				1034	00
		Advances					

Illustration — Account Sales

information as the consignor desires the consignee to have regarding same. A form of shipping invoice is shown on page 338.

Account Sales. — When the goods have been disposed of, or at stated periods — usually at the close of the month, the consignee is required to render to the shipper an accounting for the goods received on consignment. This report is in the form of a statement giving detailed information as to goods received, and their disposition. This statement is known as an *account sales*. It shows the quantity of goods received, expenses incurred in selling them, the commission, and the net proceeds. The *net proceeds* is the amount due the consignor from the consignee; it is found by deducting the expenses and commission from the total sales. When the account sales is sent to the consignor, it is usually accompanied by a remittance for the net proceeds in the form of a check, draft, or note. In some instances the net proceeds is credited by the consignee to the consignor's current personal account, which is listed with the other accounts payable. A form of account sales is shown on page 339.

Accounts in Consignor's Books. — In order to separate goods on consignment from goods in the company warehouse, and to determine the gross profit from sale of consigned goods when goods are shipped to another to sell on commission, the cost of the goods shipped is transferred from the Purchases account to a Consignment Out account. A separate account is kept with each lot of goods consigned. The title of each account contains the words "Consignment Out," the name of the consignee, and the number of the consignment. For instance, the first lot of goods shipped to T. M. Price & Company appears as Consignment Out, T. M. Price & Co., No. 1; the next Consignment Out, T. M. Price & Co., No. 2; etc. These accounts are charged with the cost of goods shipped together with any expenses incurred by the shipper in forwarding the goods, such as trucking, freight, express, insurance, etc. The accounts are credited with the net proceeds of the consignments as shown by the account sales received from consignees. Until goods shipped have been sold and accounted for, the value of the unsold consignment is considered as an asset by the consignor. This asset includes not only the original cost of the goods shipped but also any charges that may have been paid on them.

If the owner of the goods is only an "occasional shipper," the accounts with the various consignments are kept in the General Ledger. If there are many consignments, the detailed accounts are kept in a consignment ledger and a *Consignments Out* controlling account is kept in the General Ledger.

The functions of the Consignments Out account are summarized on the following page:

CONSIGNMENTS OUT

(A separate account is kept with each lot of goods shipped.)

Debit:	*Credit:*
For cost of goods shipped. (Cr. Purchases)	For net proceeds as per account sales. May be made up of (*a*) advances on account. (*b*) remittances with account sales. (*c*) proceeds charged to consignee.
For any prepaid expenses in connection with the goods shipped, such as freight, express, trucking, insurance, packing, etc. (Cr. cost or expense)	

The *balance* of the account after all goods are sold and account sales rendered represents the *gross profit on the consignment* and is shown as an addition to the gross profit on sales in the profit and loss statement.

The *balance*, when account sales has not been received nor any advances made, represents an asset and appears in the balance sheet under the heading "Current Assets," following Merchandise Inventory.

Illustration

On September 1, 19— G. T. Haines & Co. shipped to T. M. Price & Co., to be sold on their account and risk, 300 bushels of peaches which cost $2.50 per bushel. G. T. Haines & Co. paid for trucking, $50; for insurance, $25. The express, $43.50, was paid by T. M. Price & Co., on September 3. On September 10, T. M. Price & Co. sold for cash 100 bushels at $3.50, and on September 15, the balance for cash at $4 per bushel. On September 20, T. M. Price & Co. paid a storage bill of $15 and remitted the net proceeds by check after deducting 5% commission.

CONSIGNOR'S ENTRIES

At time of shipment. — A shipping invoice is made out as shown on page 338 and the following entry made in the journal:

September 1, 19—		
Consignment Out, T. M. Price & Co., No. 1	$750.00	
Purchases		$750.00
To transfer to consignment account cost of shipment — 300 bu. peaches at $2.50.		

At time the charges are prepaid by shipper. —

September 1, 19—		
Consignment Out, T. M. Price & Co., No. 1	$75.00	
Cash (or Accounts Payable)		$75.00
To charge consignment with expenses — hauling, $50; insurance, $25.		

When account sales is received. — All goods being sold, an account sales is rendered as shown on page 339 showing net proceeds of $1,034 which is remitted by check:

	September 30, 19—		
Cash		$1,034.00	
Consignment Out, T. M. Price & Co., No. 1			$1,034.00
For net proceeds as per account sales on file.			

At the end of the fiscal period when the books are closed. —

	September 30, 19—		
Consignment Out, T. M. Price & Co., No. 1		$209.00	
Profit and Loss			$209.00
To transfer gross profit on consignment to Profit and Loss account.			

After the foregoing items have been posted, the account for the consignment appears as follows in the consignor's ledger:

Consignment Out, T. M. Price & Co., No. 1

19--					19--				
Sept.	1	Cost of goods	750	00	Sept.	30	Net proceeds	1034	00
	1	Trucking	50	00					
	1	Insurance	25	00					
	30	To P. and L.	209	00					
			1034	00				1034	00

Accounts in the Consignee's Books. — The consignee keeps an account in his ledger for each consignment received by him, the title of the account indicating the shipper and the number of the shipment. If there are many of these shipments, a controlling account is kept in the General Ledger entitled *Consignments In*, while the detailed accounts are kept in a separate record known as a *consignment ledger*. Each Consignment In account is charged with all expenses and outlays on the part of the consignee for the goods received, such as transportation charges, insurance, storage, advances, commissions, etc. The account is credited for all sales of consigned goods. The net proceeds of each consignment is determined by taking the difference between the sum of the *expenses* charged to the account and the total sales credited thereto; therefore, the account balances when an account sales is rendered. The functions of the Consignments In account are summarized as follows:

CONSIGNMENTS IN

(A separate account is kept with each lot of goods received.)

Debit:	*Credit:*
For freight, express, trucking on goods when received.	For all sales of goods belonging to the consignment.
For advances to consignor on account of consignment.	
For credits to customers for returns and allowances.	
For insurance, storage, commission, and any other costs.	

The balance, if a credit, is a liability and represents the amount due the consignor; this balance is the excess of sales price over expenses and advances.

The balance, if a debit, is an asset and represents the amount due the consignee for excess of advances and expenses over sales. After the account sales has been rendered the Consignments In account balances.

A *Commissions Earned* account is also kept by the consignee and credited for all commissions on sales of consigned goods. This is an income account, the balance appearing as an addition to gross profit in the profit and loss statement.

CONSIGNEE'S ENTRIES

The entries for the consignment of G. T. Haines & Co. to T. M. Price & Co. on the books of the consignee are as follows:

At time goods are received. —

September 3, 19—

No entry for the goods except to make a memorandum in the Consignments Received record showing date received, quantity, description, marks or stencils, and any instructions regarding prices, terms, advances, etc.

At time charges are paid or expenses incurred on account of shipment. —

September 3, 19—

Consignment In, G. T. Haines & Co., No. 1	$43.50	
Cash		$43.50
To record payment of express charges on account of consignment.		

At time consigned goods are sold. —

September 10, 19—

Cash	$350.00	
Consignment In, G. T. Haines & Co., No. 1		$350.00
To record sale of 100 bu. peaches at $3.50.		

September 15, 19—

Cash	800.00	
Consignment In, G. T. Haines & Co., No. 1		800.00
To record sale of 200 bu. peaches at $4.00.		

At time account sales is rendered to consignor.—(See form shown on page 349.)

September 30, 19—

Consignment In, G. T. Haines & Co., No. 1	$15.00	
Cash		$15.00
To charge consignment with storage on peaches.		
Consignment In, G. T. Haines & Co., No. 1	57 50	
Commissions Earned		57.50
To charge consignor with commission on sales at 5%.		
Consignment In, G. T. Haines & Co., No. 1	1,034.00	
Cash		1,034.00
Net proceeds of consignment remitted by check.		

At end of fiscal period when books are closed. —

September 30, 19—

Commissions Earned	$57.50	
Profit and Loss		$57.50
To transfer to Profit and Loss account commissions on consignment.		

After posting the above entries the Consignment In account in the ledger appears as follows:

Consignment In, G. T. Haines & Co., No. 1

19--					19--				
Sept.	3	Express chg's	43	50	Sept.	10	Sales	350	00
	30	Storage	15	00		15	Sales	800	00
	30	Commission	57	50					
	30	Net proceeds	1034	00					
			1150	00				1150	00

Consignment Accounts in the Balance Sheet and Profit and Loss Statement. —

On the Consignor's Books. —Until the account sales has been received from the consignee the Consignment Out account is considered as an asset and appears in the balance sheet as a current asset following the merchandise inventory. While this amount may be included with the regular inventory, a better plan is to total all Consignment Out accounts and show as follows:

Current Assets:

****

Merchandise Inventory
Goods on Consignment

Sometimes when monthly account sales are required, part of the goods have been sold and accounted for while the balance are still on hand. In such cases the portion unsold is treated as an asset while the portion sold is closed out to Profit and Loss. For instance, assume that in the foregoing illustration T. M. Price & Co. rendered an account sales for 200 bushels of peaches sold at $4 per bushel, with charges for express and storage the same as before. The ledger account appears as follows:

Consignment Out, T. M. Price & Co., No. 1

19--						19--					
Sept.	1	Cost of goods		750	00	Sept.	30	Net Proceeds		701	50
	1	Trucking		50	00		30	Inventory		294	50
	1	Insurance		25	00						
	30	To P. and L.		171	00						
				996	00					996	00
Oct.	1	Inventory		294	50						

When all goods are sold, the balance of the consignment account represents gross profit and is transferred to the Profit and Loss account as shown on page 342. If G. T. Haines & Co. sells other goods in the regular way, then the gross profit on consignments appears as an addition to the regular gross profit in the profit and loss statement as follows:

Gross Profit on Sales	xxx xx
Add — Gross Profit on Consigned Goods	xxx xx
Total Gross Profit	xxx xx
Deduct — Operating Expenses:	

On the Consignee's Books. — Since the consignee does not own the goods, they are not shown in his balance sheet except as a footnote to indicate that they have not been added to the regular merchandise inventory. When account sales are rendered, the Consignment In accounts balance. If the proceeds have not been remitted but have been transferred to current personal accounts, they appear as regular current liabilities. The Commissions Earned account is an income account and is transferred to Profit and Loss. In the profit and loss statement commissions appear as an addition to gross profit.

Gross Profit on Sales	xxx xx
Add — Commissions Earned	xxx xx
Total Gross Profit	xxx xx
Deduct — Operating Expenses:	

Books and Records Kept. — If only an occasional consignment is made or received, no rearrangement of the books is necessary, the items being handled through the General Journal and the Sundries columns of the various special journals. However, if in addition to its regular trading business a concern receives or ships several lots of goods on consignment, special columns should be introduced in the various journals for Consignments In and Consignments Out to facilitate posting to the controlling accounts in the General Ledger, and subsidiary ledgers for both Consignments In and Consignments Out should then be used.

EXERCISE 39-a

George Smith shipped to Jones and Brown on June 1, 19—, to be sold on his account and risk, 500 bags (100#) of potatoes which cost him $2 per bag. Smith paid for hauling $30. Jones and Brown received the potatoes on June 10 at which time they paid the freight, $56.40. The entire lot was sold for cash on June 15 at $2.85 per bag. Jones and Brown paid insurance $12.50, storage $25, and charged a commission of 5%. They remitted net proceeds by check.

Required:

(*a*) Account sales.

(*b*) Journal entries for above transactions on books of George Smith.

(*c*) Journal entries for above transactions on books of Jones and Brown.

EXERCISE 39-b

April 1, 19— received from Klein & Son, New York, to be sold on their account and risk, 100 bags of Bermuda onions; paid freight and cartage $10.80.

April 5, 19— sold for cash 50 bags at $2.25; 30 bags at $2.40; and 20 bags at $2.50. Commission 5%; storage, $8.50. Proceeds credited April 6, 19—.

Required:

(*a*) Account sales.

(*b*) Journal entries to record the above transactions.

EXERCISE 39-c

Albert Rowe, St. Petersburg, Florida, shipped to Antonio Lugi, Boston, Mass., on September 1, 19—, 250 crates of strawberries, 50 boxes to a crate, which cost 10¢ per box. Trucking cost Rowe $8.50 and insurance $10.50. On September 10 Rowe drew a sight draft on Lugi for $150 which he paid. On September 6 Lugi paid $30.25 express on the shipment and $7 drayage. On September 10 Lugi sold for cash 100 crates at 20¢ a box and the remainder at 15¢. On September 20 Lugi sent a check with account sales for the balance after deducting commission of 5%.

Required:

(*a*) Shipping invoice and account sales.

(*b*) Entries on books of consignor.

(*c*) Entries on books of consignee.

EXERCISE 39-d

On July 15 Albert Willis shipped to T. B. Franklin & Co., commission merchants of St. Louis, merchandise that cost him $3,500. He paid in advance trucking $30 and insurance $18. Franklin & Co. received the goods on July 25 and paid $90 freight and $26 trucking. The sales were on account as follows: July 26, $925; July 28, $1,860; July 30, balance for $1,520. The commission and guaranty charge is 6%; and the amount of net proceeds is credited to the consignor's account.

Required:

(*a*) Account sales.

(*b*) Consignor's entries.

(*c*) Consignee's entries.

EXERCISE 39-e

On December 1, 19—, Alfred Ross of Philadelphia shipped to Robert Oakes Co. of Chicago goods costing $4,500. He paid freight on the shipment amounting to $65 and insurance $24. The goods were received on December 23 but the consignee reported that goods to the value of $1,000 were damaged in transit. The insurance company settled for this amount. Sales were made on account as follows: December 28, $2,400; December 30, $1,250. On December 31 Oakes sent an account sales for the goods that were sold, deducting commission of 5%, cartage $50, and storage $30.

Required:

(*a*) Assuming that the goods accounted for represent one-half of the shipment, show entries on the books of the consignor and consignee.

(*b*) Set up the ledger account with Consignment Out on consignor's books and with Consignment In on the books of the consignee.

EXERCISE 39-f

Explain the transactions for which each of the following entries may have been made:

(1) Cash	$2,400.00	
Consignments Out — X Co., No. 1		$2,400.00
(2) Consignment Out — X Co., No. 2	7,500.00	
Purchases		7,500.00
(3) Cash	8,420.00	
Consignment Out — X Co., No. 2		8,420.00
(4) X Company	4,350.00	
Consignment Out — X Co., No. 3		4,350.00
(5) X Company	1,460.20	
Cash	2,000.00	
Consignment Out — X Co., No. 4		3,460.20
(6) Accounts Receivable	870.00	
Consignment In — Y Co., No. 1		870.00
Consignment In — Y Co., No. 1	870.00	
Consignor — Y Co.		826.50
Commissions Earned		43.50
Consignor — Y Co.	826.50	
Cash		826.50
(7) Consignment In — Y Co., No. 2	19.20	
Cash		19.20
(8) Consignment Out — X Co., No. 5	150.00	
Profit and Loss		150.00

EXERCISE 39-g

The X Commission and Trading Company

Trial Balance, April 30, 19—

Cash	$ 4,260.89	
Accounts Receivable — Trade	2,950.00	
Accounts Receivable — Consigned Sales	1,472.00	
Notes Receivable	1,800.00	
Advances to Consignors	2,500.00	
Accounts Payable — Trade		$ 7,631.00
Accounts Payable — Consignors		1,890.75
Walter Fleming, Capital		10,000.00
Sales		18,419.26
Consignments In	12,787.30	14,891.12
Sales Returns	120.40	

Trial Balance (Cont.)

Purchases	$22,900.40	
Purchases Returns		$ 430.00
Freight Inward	312.00	
Freight Outward	122.35	
Commission		502.11
Storage		180.00
General Administrative Expenses	2,118.00	
Selling Expenses	2,641.90	
Interest Income		90.00
Purchases Discount		211.00
Sales Discount	260.00	
	$54,245.24	$54,245.24

Merchandise Inventory, $9,250

Required:

(*a*) Profit and loss statement.

(*b*) Balance sheet.

QUESTIONS FOR DISCUSSION

1. What is meant by a "consignment"?
2. Explain the following terms: consignor, consignee, commission.
3. In what particulars does a consignment differ from a sale of goods?
4. Name some reasons why goods are shipped on a consignment basis.
5. What is a shipping invoice and what information does it contain?
6. What is an account sales? What information does it contain?
7. Outline the functions of the Consignments Out account.
8. How are the consignments to different firms distinguished one from the other?
9. What is meant by "advances on account of consignments"?
10. Outline the functions of the Consignments In account.
11. Which of the consignment accounts appear in the balance sheet?
12. Which accounts with consignments appear in the profit and loss statement? How are they shown?
13. What changes are necessary in the books of a trading concern in order to handle consignments properly?
14. How are goods for various consignments identified?
15. When are Consignments In and Consignments Out accounts used as controlling accounts and when as detailed accounts?
16. What is meant by "net proceeds" as applied to consignments?
17. How is an account sales for part of a consignment shown on the consignor's books?
18. Does the Commissions Earned account represent gross or net income for the consignee?

CHAPTER XL

BRANCH OFFICES AND STORES

Purpose and Form of Branches. — Having tested out a territory by means of consignments as explained in the last chapter and finding a ready demand for its goods, a business house may decide to open a branch in that territory so as to serve its customers better and avoid the payment of heavy commissions. A *branch* is a store, office or other place of business located apart from the main store or office and placed in charge of a branch manager. While branches may be opened in the same city, frequently they are located at a distance. They, therefore, often serve as distributing points for goods, so that considerable saving is effected in transportation charges as goods may be shipped in carload lots to the branch and then distributed to the customers in small lots. The main office of the business will be referred to in this chapter as the *home office*.

Branches range all the way from agencies that merely act as selling agents for the home office to independent branches which are in many ways duplicates of the home office. The agency very often only carries samples, takes orders for home office goods, and sends them in to be filled. The home office ships the goods, sends out the invoices, and collects the accounts. Most branches, however, usually carry a stock of goods which is distributed from the branch to the customers. All goods may be received from the home office warehouse, or the branch may purchase some of them direct. The home office may also purchase the goods and have them shipped directly to the branch. Such branches collect their own accounts, pay their own bills, and remit any surplus cash on hand to the home office from time to time.

Records Kept at the Branch. — In the case of a simple agency a complete set of books is not kept. The home office is kept informed as to branch activities by means of reports. The home office usually furnished the agency with an Imprest Cash Fund for the payment of expenses. A record is kept of such expenses, and when the fund runs low the cash vouchers are sent to the home office for reimbursement. A check is remitted for the same, the whole matter being handled as explained in Chapter XXXVI. On the other hand, a branch receiving goods from the home office, buying goods on its own account, collecting customers' accounts, and paying expenses and creditors,

usually keeps a simple set of books containing accounts with the ordinary trading accounts, customers, creditors, expenses, etc. The fixed assets of the branch such as Buildings and Equipment, however, are usually kept on the books of the home office.

Ledger Accounts on Home Office Books. — The home office keeps a ledger account with each branch which is handled very much the same as the Consignments Out account described in the last chapter. The name of the account very often indicates the location of the branch, such as "Buffalo Branch." The account is charged with all merchandise sent to the branch at *cost*, with cash remitted to the branch, and with all expenses paid by the home office for the branch. The account is credited with all remittances by the branch to the home office and any expenses of the home office paid by the branch. The functions of this account may be summarized as follows:

BRANCH OFFICE
(on home office books)

Debit:	*Credit:*
For cost of goods shipped to the branch from warehouse.	For cash remitted to home office.
For any transportation charges paid on goods shipped to branch.	For goods returned to home office at cost.
For goods purchased for branch and shipped direct.	For any home office expenses paid by branch.
For cash remitted to branch.	For loss as shown by branch books.
For any expenses paid on account of branch.	
For profit as shown by branch books.	

The balance of this account represents the investment of the home office in the branch and consists of the net worth of the branch as shown by the branch books. It is a controlling account for the branch activities. It may appear on the home office balance sheet as a fixed asset, but in preparing this statement it is better practice to combine the assets and liabilities of the branch with those of the home office.

Where there are several branches a Branch Profit and Loss account may be used in order to show the total result of branch trading. This is closed into the regular Profit and Loss account in the usual manner.

Illustration

On June 1 the home office of the Central Trading Co. sent to its branch at Cleveland goods costing $5,000 and $1,000 in cash. During the month of June the following trans-

actions took place: Sales on account, $6,000; cash receipts from customers, $5,000; branch expenses paid in cash, $250; cash remitted to home office, $4,500. Inventory of goods on hand, June 30, 19—, $1,500.

The entries on the home office books for the above items in general journal form are:

June 1, 19—

Cleveland Branch	$6,000.00	
Purchases		$5,000.00
Cash		1,000.00
Goods and cash sent to establish branch at Cleveland.		
Cash	4,500.00	
Cleveland Branch		4,500.00
Remittances received from branch.		

June 30, 19—

Cleveland Branch	2,250.00	
Branch Profit and Loss		2,250.00
To charge branch with profit as shown by statements submitted.		

After posting the above items the Cleveland Branch control account on the home office books appears as follows:

Cleveland Branch

19--					19--				
June	1	Goods shipped	5000	00	June	30	Cash received	4500	00
	1	Cash remitted	1000	00					
	30	Profit for mo.	2250	00					

Ledger Accounts on Branch Books. — The branch office keeps on its books an account with the home office which is handled in much the same way as the Consignments In account described in the last chapter. This account takes the place of a capital account on the branch books. It contains the same items as the controlling account with the branch on the home office books, but on the opposite sides.

The current transactions on the branch books are recorded on a double entry basis in the same manner as on the home office books or for any other business, accounts being kept with purchases, sales, expenses, customers, creditors, etc. The items debited and credited to this account are practically the reverse of those debited and credited to the Branch account on the home office books as shown on page 351 and may be summarized as follows:

HOME OFFICE ACCOUNT
(On branch office books)

Debit:	*Credit:*
For cash remitted to home office.	For goods received from home office warehouse.
For goods returned to home office.	For charges on goods paid by home office.
For any expenses paid for the home office.	For goods bought by home office and shipped direct.
For loss of branch, if any.	For cash received from home office.
	For expenses paid by home office for branch.
	For profit of the branch, if any.

The balance represents the accountability of the branch to the home office.

The entries on the Cleveland Branch books for the items in the above illustration of the Central Trading Co. are as follows:

June 1, 19—

Cash	$1,000.00	
Purchases	5,000.00	
Home Office		$6,000.00
Cash and goods received from home office.		
Accounts Receivable	6,000.00	
Sales		6,000.00
Sales for the month.		
Cash	5,000.00	
Accounts Receivable		5,000.00
Receipts from customers during month.		
Expenses	250.00	
Cash		250.00
Branch expenses paid in cash.		
Home Office	4,500.00	
Cash		4,500.00
Cash remitted to home office.		

After setting up the inventory for $1,500 and closing the nominal accounts into the Profit and Loss account in the usual manner, the following entry is made to close the Profit and Loss account into the Home Office account.

Profit and Loss	$2,250.00	
Home Office		$2,250.00
To close profit for month to Home Office account.		

After posting the above entries the Home Office account on the branch books appears as follows:

Home Office

19--					19--				
June	30	Cash remitted	4500	00	June	1	Cash	1000	00
						1	Goods	5000	00
						30	Profit	2250	00

Compare this account with the account with Cleveland Branch shown on page 352.

The balance sheet of the branch will then appear as follows:

Cleveland Branch
Balance Sheet, June 30, 19—

Assets		Liabilities	
Cash	$1,250.00	Home Office	$3,750.00
Accounts Receivable	1,000.00		
Merchandise Inventory	1,500.00		
	$3,750.00		$3,750.00

Goods Shipped to Branch at Selling Price. — The above discussion and illustration applies especially to a wholesale business, in which case the branches sell to retail stores. In some lines, such as the chain grocery store, the main office consists of a warehouse which ships goods to branch stores to sell to the consumer. In such cases, in order to keep a closer control over the goods, they are charged to the branch store at the selling price instead of the cost price as illustrated above. The store keeps no books, but reports daily or weekly to the main office a summary of the transactions. The receipts for each day are usually turned over to a collector from the main office or deposited in a nearby bank. These stores are permitted to buy such goods as bread, cakes, milk, yeast, etc., and pay for same from the cash drawer. They are also permitted to pay certain expenses such as help, ice, express charges, etc. The store

is charged with all goods delivered to it and credited for its cash payments and the amount turned over to the collector or the bank. A form of daily report sent to the main office is shown below:

CENTRAL GROCERY COMPANY

DAILY CASH REPORT

Store No. _____ Manager

Day Date Year

Register Reading After Last Sale Today		
" " " " " Yesterday		
SALES FOR TODAY		
Expenditures (per itemized report on reverse side)		
BALANCE — DEPOSITED IN BANK		

O.K.'d by Approved by

Name of Bank

City or Town

Ent'd C.B. ____ Pg. ____

(Bank Stamp)

Deposited by
CENTRAL GROCERY COMPANY
Boston, Mass.

Date 19

	Dollars	Cents
Bills		
Gold		
Silver		
Checks on		
"		
"		
"		
"		
"		
"		
Total		

Illustration — Daily Cash Report (front)

CASH EXPENDITURES

Store No..... Date Year

Paid out as follows:

Merchandise		Cost	Retail
Bread, Cakes	at		
Yeast	at		
Ent. C.B.....	Total Merchandise		
	EXPENSES		
Help			
Ice			
Express			
Ent. C.B.....	Total Expenses		
Combined Total Carried on Reverse Side			

.....Manager

Office Approval.....

Remarks:_____

Illustration — Daily Cash Report (back)

In order to receive *credit* for goods transferred to another store or for goods short or damaged on load from warehouse, or for any other credits except for change in price, a form known as a Store Credit Form must be filled out. This is made out in duplicate, one copy going to the main office and the other being retained by the store manager. A form of credit sheet is shown on page 357.

In the same manner, if the store is to be *charged* for goods transferred from another store, or for an excess of goods on a load being delivered from the warehouse, or for any other charges except change in price, a Store Charge slip is made out in duplicate. This is identical in form with the Store Credit slip but it differs in color to avoid confusion.

When a change in price is ordered by the main office, each branch manager is notified by a Change in Price slip and each branch account is credited for the decrease and charged for the increase in price. The form of Change in Price slip is illustrated on page 358.

To be used to credit your store for goods transferred to another store, for goods short or damaged on load from warehouse, and any other credits to your store for which there is not a regular form. Not to be used for any change in price.

CENTRAL GROCERY COMPANY

STORE CREDIT

Supt._____ Date_____ 19____

Store_____

Use Store Stamp

Quantity	Article, Brand and Size	Retail Price	Extension	
			Retail	Cost
				Manager must not write beyond this line
	Total Credit to Your Store			

Explanation of Credit

Instructions to Managers:

If used to correct an invoice, note date of invoice.
Always give explanation in full. Supt. will O. K. and send in to the office.
Duplicate must never be taken from book.

Illustration — Credit Sheet

After the items entered on the forms illustrated on pages 355-358 have been recorded in the accounts with the various stores in the main office ledger, the balances of these accounts should equal the amount of goods on the shelves in the various stores at the sales price. In order to keep a check on this a representative of the main office visits the stores at frequent intervals and takes a physical inventory, the sales value of which is compared with the amounts shown in the main office books. An allowance is usually made for slight variations in amounts.

CHANGE IN PRICE SLIP

CENTRAL GROCERY CO.

Store No. _____
Use Store Stamp

Date _____

Letter No. _____
(or other authority)

INSTRUCTIONS TO MANAGER: This slip is to be used only to charge or credit your store when price changes occur, and if goods are sold at a reduced price or for special sales. To be taken out only by superintendent.

Article	Old Price	New Price	Mark Up	Mark Down	Stock on Hand	Extension	
						Amt. Up	Amt. Down

Audited _____ _____
Superintendent Manager

Illustration — Change in Price Slip

EXERCISE 40-a

A firm opens a branch in St. Louis on November 1, 19—. The following transactions take place during the month of November:

Cash sent to the branch, $1,000.

Goods shipped from home office warehouse to the branch at cost, $10,000.

Goods purchased from outsiders on account by the branch, $1,500.

Sales on account at branch for the month, $9,500; cash sales, $3,500.

Branch received from customers on account, $8,500.

Paid creditors on account, $1,250; paid expenses at branch, $2,500.

Cash remitted to home office, $8,400.

Inventory of goods on hand at branch November 30, $3,000.

Required:

(*a*) Entries on the books of the home office.

(*b*) Entries on the books of the St. Louis branch.

(*c*) Set up in T ledger form the account on the home office books for St. Louis branch and the account on the St. Louis branch books with the home office.

(*d*) Prepare a balance sheet of the branch.

EXERCISE 40-b

Balance Sheet

Boston Branch, August 31, 19—

Assets		Liabilities	
Cash	$ 4,378.60	Accounts Payable	$ 1,540.00
Accounts Receivable	2,465.30	Home Office	10,736.00
Merchandise Inventory	5,432.10		
	$12,276.00		$12,276.00

The following transactions take place during the next month:

Goods received from Home Office warehouse	$ 9,825.40
Sales on account	13,832.00
Cash sales	1,540.00
Cash received from customers	14,376.70
Cash remitted to Home Office	15,000.00
Goods purchased from outsiders	2,540.00
Cash paid creditors	2,350.00
Cash paid for freight and cartage	174.20
Cash paid for other expenses	754.20
Inventory at close of month	4,850.00

Required:

(*a*) Journal entries for the transactions of the branch as they would be recorded on both the home office and branch books.

(*b*) Necessary closing entries for branch books.

(*c*) The necessary entry to take up profit or loss on home office books.

(*d*) A summary of transactions between the branch and home office as shown by the Branch account on home office books and Home Office account on branch books. Set up ledger accounts in T form.

(*e*) Balance sheet of branch.

EXERCISE 40-c

The Western Manufacturing Co. opened a branch office in Indianapolis on September 1, 19— and installed George Roberts as manager. The following transactions took place during the month of September:

Sept. 1. Home office paid $250 for rent of branch office for September.

1 Sent check to branch for $300 to be used for current expenses.

1 Shipped from warehouse goods costing $6,500.

1 Paid freight on shipment to branch, $65.

2 Purchased from Roger Wilson goods, $750, and ordered them shipped directly to branch.

3 Ordered Cleveland branch to transfer to Indianapolis branch $500 of goods not in stock at home office.
4 Branch reports sales on account, $350. Cash sales to date, $520.
5 Branch remits to home office, $750 cash.
6 Branch buys merchandise on account, $600.
7 Branch sales on account, $1,250; cash sales, $340.50.
8 Shipped to branch from warehouse goods costing $325.
10 Branch pays expense bills amounting to $125.40; salaries, $200.
12 Branch returns to home office goods that are unsalable, $342.
15 Branch sales on account, $2,436; for cash, $543.
18 Branch collects from customers, $4,754.
20 Branch allowed customers credits amounting to $78.20.
22 Branch remitted to home office, $3,850.
25 Salaries and expenses paid by branch, $605.
28 Sales at branch on account, $2,345.
30 Home office pays expense bills for branch, $245.
30 Branch advances $500 to home office manager for traveling expenses.
30 A physical inventory at branch shows goods on hand, $3,620.

Required:

(*a*) Entries necessary to record the above transactions on the books of both the branch and the home office.

(*b*) Closing entries for the branch books.

(*c*) Entry to take up profit or loss on home office books.

(*d*) Ledger accounts on home office and branch books to show summary of transactions between branch and home office.

(*e*) Balance sheet of branch at end of month.

QUESTIONS FOR DISCUSSION

1. State reasons for the establishment of a branch store or branch office.
2. Name some lines of business that market their goods through branch stores.
3. What type of bookkeeping records are kept at the branch offices?
4. What ledger accounts are kept on the home office books to record the activities of the branches?
5. How is the investment of the home office in the branch shown in the balance sheet at the end of the fiscal period?
6. What ledger accounts are kept on the books of the branch?
7. For what purpose are goods sometimes shipped to the branches at the selling price instead of the cost price?
8. What type of bookkeeping records are kept by retail branch stores?
9. Explain the method of handling transfers of goods from one store to another, changes in prices, shortages, etc.

CHAPTER XLI

C.O.D. AND INSTALMENT SALES

C.O.D. Sales. — When a customer desires goods shipped before his financial standing can be investigated, or when a customer is known to have no credit standing or has exceeded his line of credit, it is desirable not to make delivery of the goods until the purchase price has been collected. Such shipments must be paid for at the time of delivery and are known as C.O.D. (cash on delivery) sales. The method of handling such sales depends upon the time required for delivery and the method of delivery. If the customer is located in the same city, delivery is made by messenger, the seller's own delivery men, or by local express. If out of town or at a distance, delivery is made by express, parcel post, or freight. The procedure under the various methods is outlined below.

Local Delivery. — The various packages are charged to the delivery men on the various route sheets when the goods are taken from the delivery department. The delivery men are credited for the collections turned in at the end of the day and the undelivered packages which are carried over onto the sheet for the next day. The regular sales slips are pasted upon a large manila card which has C.O.D. printed on it in large red letters so that such packages will not be delivered without collection being made.

Parcel Post Delivery. — When goods are shipped by parcel post the Post Office Department provides a special tag which is attached to the package. One side of this tag shows the customer's name and address and the amount to

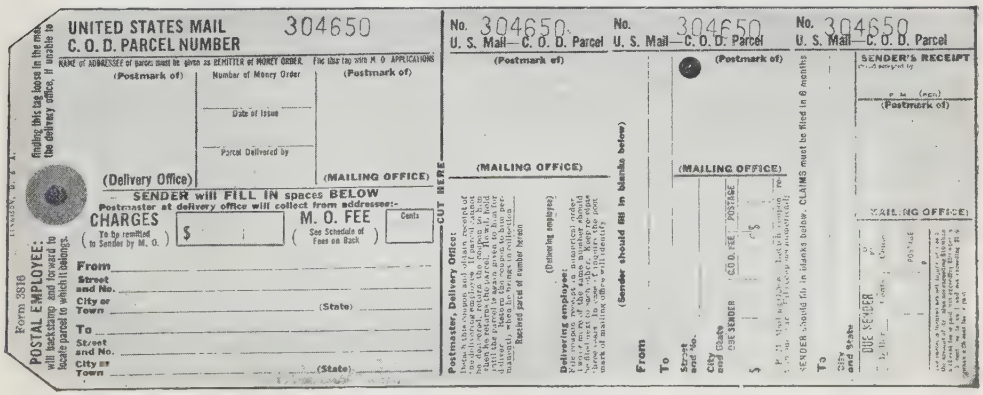


Illustration — Parcel Post C.O.D. Tag

be collected before delivery. The other side contains a schedule of the money order fees. When the goods arrive at their destination, the Post Office Department holds them until the charges shown on the tag are paid. When payment is received and goods delivered, the proceeds are remitted to the sender in the form of a postal money order.

Express Delivery. — The sales invoice is enclosed in a special C.O.D. envelope which is attached to the package. When the goods arrive the express company holds them until the invoice and charges are paid. After payment is received and the goods delivered the express company inserts in the envelope an express money order and returns the same to the shipper by mail. Unless the shipper specifies that the consignee is to pay the charges they are deducted from the amount of the bill.

Illustration — Express C.O.D. Envelope

Freight Delivery. — A slightly different procedure is necessary when goods are shipped by freight. An *Order Bill of Lading* is made out by the shipper consigning the goods to the *order of the shipper*, or a bank, with instructions for the railroad to *notify* the consignee when the goods arrive. The original bill of lading with a sight draft attached is forwarded by the shipper to a bank in the city where the goods are to be delivered. The railroad company does not handle the money for the shipper. Therefore, the consignee is notified to call at the bank, pay the draft and receive the original bill of lading which he then presents to the railroad company and receives his goods. The bank then remits the proceeds of the draft to the shipper. The following is a form of Order Bill of Lading:

Uniform Domestic Order Bill of Lading Adopted by Carriers in Official, Southern and Western Classification Territories, March 15, 1922

THIS MEMORANDUM is an acknowledgment that a Bill of Lading has been issued and is not the Original Bill of Lading, nor a copy or duplicate, covering the property named herein, and is intended solely for filing or record.

Shipper's No. 8246

Agent's No. 127

INTERNATIONAL TRANSPORTATION COMPANY

Uniform Domestic Order Bill of Lading Adopted by Carriers in Official, Southern and Western Classification Territories, March 15, 1922

THIS SHIPPING ORDER must be legibly filled in, in Ink, in Indelible Pencil, or in Carbon, and retained by the Agent.

Shipper's No. 8246

Agent's No. 127

INTERNATIONAL TRANSPORTATION COMPANY

Uniform Domestic Order Bill of Lading Adopted by Carriers in Official, Southern and Western Classification Territories, March 15, 1922

UNIFORM ORDER BILL OF LADING

(PRESCRIBED BY THE INTERSTATE COMMERCE COMMISSION)

Shipper's No. 8246

ORIGINAL

Agent's No. 127

INTERNATIONAL TRANSPORTATION COMPANY

RECEIVED, subject to the classifications and tariffs in effect on the date of the issue of this Bill of Lading,

at Yonkers, N. Y. January 5, 192 -

from E. R. WHITCOMB & CO.

the property described below, in apparent good order, except as noted (contents and condition of contents of packages unknown), marked, consigned, and destined as indicated below, which said company (the word company being understood throughout this contract as meaning any person or corporation in possession of the property under the contract) agrees to carry to its usual place of delivery at said destination, if on its own road or its own water line, otherwise to deliver to another carrier on the route to said destination. It is mutually agreed, as to each carrier of all or any of said property over all or any portion of said route to destination, and as to each party at any time interested in all or any of said property, that every service to be performed hereunder shall be subject to all the conditions not prohibited by law, whether printed or written, herein contained, including the conditions on back hereof, which are hereby agreed to by the shipper and accepted for himself and his assigns.

The Surrender of this Original ORDER Bill of Lading properly indorsed shall be required before the delivery of the property. Inspection of property covered by this bill of lading will not be permitted unless provided by law or unless permission is indorsed on this original bill of lading or given in writing by the shipper.

(Mail or street address of consignee—For purposes of notification only)

Consigned to **ORDER OF** LIBERTY TRUST COMPANY

Destination Boston State of Mass. County of

Notify J. T. AMES & CO.

At 95 Park Street, Boston State of Mass. County of

Route N. Y., N. H., & H.

(Delivering carrier) Car Initial B. & M. Car No. 2360

No. Packages	DESCRIPTION OF ARTICLES, SPECIAL MARKS, AND EXCEPTIONS	*WEIGHT (Subject to Correction)	CLASS OR RATE	CHECK COLUMN
6	Wilton Rugs	300		

If this shipment is to be delivered to the consignee without recourse on the consignor, the consignor shall sign the following statement:

The carrier shall not make delivery of this shipment without payment of freight and all other lawful charges. (*See section 7 of conditions.*)

(Signature of consignor)

If charges are to be prepaid write or stamp here, "To be Prepaid"

To be Prepaid

Received $ 6.50 to apply in prepayment of the charges on the property described hereon.

Susan Barton

Agent or Cashier.

Per

(The signature here acknowledges only the amount prepaid.)

Charges Advanced

$

*If the shipment moves between two ports by a carrier by water, the law requires that the bill of lading shall state whether it is "carrier's or shipper's weight."

NOTE.—Where the rate is dependent on value, shippers are required to state specifically in writing the agreed or declared value of the property.

The agreed or declared value of the property is hereby specifically stated by the shipper to be not exceeding

$1200.00 per 6 Rugs

E. R. WHITCOMB & CO. Shipper. Susan Barton Agent.

Per C. C. Per

Permanent post-office address of shipper, 140 Hill Street, Yonkers, N. Y.

Recording C.O.D. Sales. — While "C.O.D." refers to the terms of sale, and the sale is frequently recorded as a regular accounts receivable by debiting the customer and crediting Sales account in the Sales Journal when the goods are shipped and debiting Cash and crediting the customer in the Cash Receipts journal when payment is made, it is advisable to keep an accurate record of such items in a special C.O.D. account. This account is kept in the Accounts Receivable Ledger the same as accounts with customers.

Illustration

January 10, shipped by freight on shipper's order to J. T. Ames & Co., Boston, goods valued at $1,200 and sent original bill of lading with sight draft attached to Liberty Trust Co. of that city for collection. January 12, shipped by express C.O.D. to Smith & Ross, Albany, N. Y., goods valued at $500. January 18, received express money order for $500 for goods shipped C.O.D. to Smith & Ross on January 12. Consignee paid all charges.

When the goods are shipped the entry is made in the Sales Journal charging the C.O.D. account by writing C.O.D. followed by the name of the consignee in the Account Dr. column as shown below:

Sales Journal

Date	L. F.	Account Dr.	Address	Terms	Sales No.	Amount	Total
19—							
Jan 10		C.O.D. — J. T. Ames & Co.	Boston	Sight Draft B/L		1200 00	
12		C.O.D. — Smith & Ross	Albany, N. Y.	C.O.D. — Am. Ex.		500 00	

When the proceeds of the shipment to Smith & Ross are received on January 18, the express money order is entered in the Cash Receipts Journal, crediting C.O.D. — Smith & Ross in the Account Cr. column and extending the amount to the Accounts Receivable column as shown below:

Cash Receipts Journal

Date	L. F.	Account Cr.	Particulars	Sundry Credits	Accts. Rec.	Disc. on Sales	Net Cash Rec'ts
19—							
Jan. 18		C.O.D. — Smith & Ross	M.O. for shipment Jan. 12		500 00		500 00

When posted to the C.O.D. account in the Accounts Receivable Ledger, the above items appear as shown on the following page. Note that the cus-

tomer's name appears in the explanation column and that the credit for each item is recorded on the same line as the debit.

C.O.D.

19—						19—					
Jan.	10	J. T. Ames & Co.	1200	00							
	12	Smith & Ross	500	00		Jan.	18	Cash		500	00

If an extensive C.O.D. business is carried on it might be well to separate the freight, express, and parcel post C.O.D. items by setting up three ledger accounts; C.O.D. — Freight, C.O.D. — Express, and C.O.D. — Parcel Post. Local C.O.D. items are usually handled as cash sales.

Instalment Sales. — It is common practice to sell many kinds of merchandise on the instalment plan, a portion of the purchase price being paid at the time of the sale and the balance in equal weekly or monthly instalments. Automobiles, pianos, radio outfits, electrical apparatus, furniture, and even clothing are marketed in this manner, many concerns selling practically all their goods on this plan. As the seller still retains ownership of the goods, the transaction does not represent a completed sale and is more in the nature of a sales contract. The records should show at the end of each fiscal period the amount paid on such contracts, the amount still owing, the profits earned, and the investment in the merchandise.

Instead of crediting such items to the regular sales account when the sale is made, a special account known as Instalment Sales account is used. The sale is debited to an Instalment Contracts account and credited to Instalment Sales account. This has the effect of separating the instalment contracts from the regular accounts receivable and instalment sales from regular sales. As payments are made on account they are credited to the Instalment Contracts account. An entry is then made transferring the amount of the payments from the Instalment Sales account to the regular Sales account. In this way only that portion of Instalment Sales that are actually paid for are included in sales income. At the end of the period the proportion of the cost of the asset paid for is transferred from the Purchases account to the Sales account, the balance of which then represents the gross profit on instalment sales.

The amount to be credited to Purchases is found by taking that proportion of the cost that the total instalments received bears to the total selling price. Thus, if an article costing $120 is sold for $200 and at the end of the period $50 has been paid, then $\frac{50}{200}$ or $\frac{1}{4}$ of the selling price has been re-

ceived, and $\frac{1}{4}$ of the cost, or $30, is charged to the Sales account leaving a gross profit of $20.

Illustration

On September 1, 19— The Capital Electric Co. sold to Robert E. Bacon a radio outfit for $120 on the instalment basis. The terms were $24 down and the balance in eight monthly instalments of $12 each. The outfit cost the Capital Electric Co. $65. The entries in general journal form are as follows:

1. At time sale is made September 1:

Instalment Contracts — Robert E. Bacon	$120.00	
Radio Instalment Sales		$120.00
To record sale of radio.		
Cash	24.00	
Instalment Contracts — Robert E. Bacon		24.00
To record down payment on contract.		
Radio Instalment Sales	24.00	
Radio Sales		24.00
To transfer payment to sales account.		

2. At time monthly instalments are paid:

Cash	12.00	
Instalment Contracts — Robert E. Bacon		12.00
To record monthly payment on contract.		
Radio Instalment Sales	12.00	
Radio Sales		12.00
To transfer payment to sales account.		

3. At close of year to adjust Radio Purchases and Sales accounts:

December 31, 19—

Radio Sales	$ 32.50	
Radio Purchases		$ 32.50
To transfer to sales account the proportion of instalment sales paid for.		

The amount of the above entry is found by taking the proportion of cost that payments received bear to sales price. By referring to the ledger account shown on the following page the payments are found to be $60 and the sales price $120. Therefore, $\frac{60}{120}$ or $\frac{1}{2}$ of the selling price has been received and $\frac{1}{2}$ of the cost, or $65, is $32.50. Where an extensive instalment business is carried on it is the practice to use an average of all instalment sales in adjusting the items rather than to adjust each item separately.

After posting, the ledger accounts affected by the above entries, with the exception of cash, appear as shown below:

INSTALMENT CONTRACTS LEDGER

Robert E. Bacon

19--					19--				
Sept.	1	Radio Outfit	120	00	Sept.	1	Cash payment	24	00
					Oct.	1	2d "	12	00
					Nov.	1	3d "	12	00
					Dec.	1	4th "	12	00

GENERAL LEDGER

Instalment Contracts

19--					19--				
Sept.	1	Radio	120	00	Sept.	1	Cash	24	00
					Oct.	1	"	12	00
					Nov.	1	"	12	00
					Dec.	1	"	12	00

Radio Instalment Sales

19--					19--				
Sept.	1		24	00	Sept.	1	R. E. Bacon	120	00
Oct.	1		12	00					
Nov.	1		12	00					
Dec.	1		12	00					

Radio Sales

19--					19--				
Dec.	31	Cost	32	50	Sept.	1	Instal. Sales	24	00
					Oct.	1	" "	12	00
					Nov.	1	" "	12	00
					Dec.	1	" "	12	00

Radio Purchases

19--					19--				
Sept.	1	Cost	65	00	Dec.	31	To Sales	32	50

The above accounts, in order to illustrate the principle involved, show only the transactions with Robert E. Bacon carried through until the end of the

year. In practice the Instalment Contracts Ledger contains the detailed accounts of *all* customers buying on the instalment plan. The Instalment Contracts account in the General Ledger is the controlling account for these details. The balance of this account represents the total amount unpaid on all instalment contracts, whether for radio outfits or any other line sold on this plan. The Radio Instalment Sales account shows on the credit side the total sale price of radios sold on instalments while the debit side shows amounts paid. The balance represents the balance outstanding on radio contracts only.

The Instalment Contracts account may be shown on the asset side of the balance sheet while the Radio Instalment Sales account and other instalment sales accounts may be shown among the liabilities and should be marked "Contra" to indicate that they offset the Instalment Contracts account shown on the asset side.

Radio Sales account in practice is credited with the amount actually paid on radio contracts and with all other sales of radios other than on an instalment basis. It is debited with the cost of all radios sold, the balance representing total gross profit on radio sales, and appears in the trading section of the profit and loss statement. The Radio Purchases account is the regular inventory account and appears in the balance sheet as a current asset. The journals are often ruled with special instalment columns to simplify the bookkeeping procedure.

Instalment Goods Reclaimed. — If the company has to reclaim the goods on account of unpaid instalments, the inventory account must be readjusted. In such instances the amount paid practically represents rental income against which should be charged any expenses incurred in repairing or putting in salable condition the articles taken back.

For instance, in the above illustration, assuming that Robert E. Bacon fails to pay his January instalment and the company is obliged to take back the radio outfit, an entry is made to adjust the inventory account by charging it with the amount transferred to the Sales account on December 31, 19—. This may be credited to the Radio Sales account, to some special income account, or more properly to surplus as an adjustment of the previous year's income.

Radio Purchases	$ 32.50	
Radio Sales (or Income from Radios reclaimed)		$32.50
To charge inventory with portion of cost transferred to sales account.		

Assuming that it cost $20 to put the radio in salable condition, the entry for this item will be:

Radio Sales (or Income from Radios Reclaimed)	$20.00	
Cash		$20.00

Approval Sales. — Goods are sometimes shipped to customers on approval, there being no obligation on the part of the customer to keep the goods unless he so desires. A time limit should be agreed upon within which the goods must be returned or considered as a sale. Such shipments are really not sales and should not be included in the sales account. A distinction must be made between goods sold subject to return if not satisfactory and those shipped on approval. The usual practice in retail stores is to charge the goods in both cases to the customer in the usual way and then credit him when the goods are returned. A more correct practice in approval sales, if the amounts are *large*, is to set up memorandum accounts when shipped so that sales will not be inflated.

For instance, assume that a rug dealer sends a $600 rug to a customer on approval; the entry is

Goods on Approval	$600.00	
Approval Sales		$600.00
Shipped rug to X on 10 days' approval.		

If the rug is returned the above entry is reversed. If the rug is retained the above entry is reversed and the item is recorded as a regular sale. A detailed record is kept showing the customer's name and location. When a balance sheet is prepared while such items are out on approval, the goods are included in the regular inventory. The memorandum accounts need not appear in the balance sheet.

Ticket and Coupon Sales. — Some lines of business, such as milk dealers, ice dealers, restaurants, street railways, etc., sell tickets or coupons which are later exchanged for goods or services. Such items should not be credited to sales when sold as they represent an agreement to deliver the goods rather than an actual transfer of the goods themselves. At the time the tickets or coupons are sold the proceeds should be credited to *Coupons Redeemable* account. Later when the tickets are redeemed an entry is made transferring the amount to the regular sales account.

For instance, assume that an ice dealer sells ice coupon books each good for 500 pounds of ice, each coupon calling for 25 pounds of ice. As ice is delivered from day to day the coupons are torn from the book and handed to the driver. Assume that $100 of coupons have been sold and that on a certain date the driver turns in $25 of coupons. The entries are as follows:

For the sale of the coupons:

Cash	$100.00	
Coupons Redeemable		$100.00

For the coupons redeemed and turned in by driver:

Coupons Redeemable	$25.00	
Ice Sales		$25.00

In this instance the balance of the Coupons Redeemable account is $75 which is a liability of the ice dealer to deliver that amount of ice to his customers. By recording in this manner each period will show the correct amount of actual sales and profits, and the value of the unredeemed coupons is shown in the balance sheet as a current liability.

EXERCISE 41-a

The following items are taken from the books of the Gordon Trading Co., Boston:
November, 19—

1 Sold goods to L. G. Brown Co., Chicago, for $1,245; terms sight draft at 30 days.
2 Sold goods valued at $25 to Robert Cornell, New York; terms C.O.D. parcel post.
5 Sold goods valued at $165 to Fred J. Libby, Cincinnati; terms C.O.D. American Express.
8 Received postal money order for proceeds of shipment to Robert Cornell on November 2.
10 Sold goods to G. M. Wildman & Co., Cleveland, Ohio, valued at $1,850; terms sight draft against an order bill of lading.
12 Received express money order for $164.35, proceeds of shipment to Fred J. Libby on November 5. The express company retained 65¢ for charges.
15 Sold goods to A. C. Colby, Chicago, Ill., valued at $2,450; terms sight draft against an order bill of lading less 2%.
18 Sold goods to H. W. Hayes, city, valued at $75; terms C.O.D. Driver reports delivery and turns in cash to cashier.
20 Sold goods to W. A. Lohnes & Co., Akron, Ohio, for $150; terms C.O.D. express.

Required:

(*a*) Rule headings for Sales Journal and Cash Receipts Journal in accordance with forms shown on page 364 and record the above items therein.

(*b*) Set up a T ledger account for the C.O.D. account and show posting of the above items thereto.

EXERCISE 41-b

The Marion Music Company sells pianos on the instalment plan. On July 15,

19— W. B. Cornell purchased a piano from the company for $300, to be paid for as follows: $25 down and the balance in monthly instalments of $15 each, bill of sale to be given on date of final payment. The piano was purchased July 1, 19— and cost the company $120. The instalments for the year ending December 31, 19— were received, the last one being paid on December 15.

Required:

(*a*) Journal entries recording the purchase and sale of the piano and the various payments thereon during the year.

(*b*) Set up T ledger accounts and post the above entries.

(*c*) The journal entry at the end of the fiscal period December 31, 19— by which the Piano Inventory account will be properly adjusted, and the Piano Sales account will be credited with its proper proportion of the profit on this transaction for the year.

EXERCISE 41-c

A music company sells a phonograph to J. G. Hart on November 15, 19— for $75; terms $10 down and $5 per month. The books are closed at the end of the fiscal year December 31, 19— after the first monthly payment has been received. The phonograph was purchased November 1, 19— and cost the company $35. Hart fails to pay the January instalment and the phonograph is reclaimed by the music company. After spending $10 to place it in first-class condition, it is placed back in stock.

Required:

(*a*) Journal entries to record the sale of the phonograph and the payments on account of same during the year.

(*b*) Open ledger accounts and post the above entries.

(*c*) Make journal entry on December 31 to adjust the inventory account and show correct profit for the year.

(*d*) Journal entries required to adjust the accounts on account of reclaiming and placing in stock the phonograph in January.

EXERCISE 41-d

A restaurant sells meal tickets good for $5.25 of food for $5.00 each. During the month of January 100 tickets were sold. During the same period meal checks amounting to $415 were paid from the tickets.

Required:

(*a*) Entries to record the sale of tickets and redemption of the meal tickets during the month.

(*b*) What is the amount of the restaurant's liability to its customers and how is the same shown on the balance sheet?

EXERCISE 41-e

A milk dealer sells strips of milk tickets, each ticket good for a pint of milk. Dur-

ing the month of December he sells tickets amounting to $725. The drivers collect during the month $610 in tickets and $150 in cash.

Required:

(*a*) Entries to record the sale of tickets and the receipt of tickets and cash during the month.

(*b*) State the dealer's liability to his customers and explain how same is shown in the balance sheet.

QUESTIONS FOR DISCUSSION

1. What is meant by a C.O.D. sale? Name some of the reasons for shipping goods under this plan.

2. Explain the different methods of shipping goods C.O.D.

3. What special records are necessary when goods for local delivery are sold C.O.D.?

4. In what particulars does the shipment by freight C.O.D. differ from that by express or parcel post?

5. What is meant by an *order bill of lading* and how does it differ from a *straight bill of lading?*

6. Explain the procedure of shipping goods subject to a sight draft against an order bill of lading.

7. Explain how the C.O.D. account is operated.

8. In what form does the shipper receive his remittance for C.O.D. express and parcel post shipments?

9. What is meant by instalment sales? Name some of the commodities sold under this plan.

10. Name the special accounts used for instalment sales and state their functions.

11. In looking over a set of books it is found that the bookkeeper has credited the total of the instalment sales to an Instalment Sales account, which has been closed into Profit and Loss account. What objection is there to this procedure?

12. What is meant by approval sales?

13. A business house makes many shipments of goods on approval and treats the transactions as regular sales. What objection is there to this method?

14. A considerable portion of the sales of a company are made with the understanding that if not satisfactory they may be returned any time within 10 to 30 days, depending on the commodity. Is this considered as an approval sale?

15. A furniture dealer makes an instalment sale amounting to $300, which is double the cost. During the first year instalments amounting to $75 were collected. During the second year no instalments were collected and the furniture was taken back undamaged. Outline the procedure for handling these items on the books.

16. Explain why tickets and coupons sold, to be redeemed later in goods or services, should not be treated as regular sales. Outline the procedure for handling such items.

SUMMARY OF CHAPTERS XXXIX–XLI

A consignment is a shipment of goods by the owner to another to be sold on commission. It is a method of marketing perishable goods, and goods that fluctuate in price. It is also a means of testing out new markets before establishing branches.

The consignor keeps an account of each shipment of goods on consignment which is charged with the cost of goods and expenses paid and credited for the net amount returned by the consignee. The balance of the account represents the gross profit on the consignment.

The consignee keeps an account with each invoice of goods received which he charges with expenses paid by him, with his commission, and with the net proceeds when remitted to the consignor. He credits this account for all sales of goods belonging to the consignor.

Goods on consignment appear in the balance sheet of the consignor as an asset until sold. When sold the gross profit appears in the profit and loss statement as an addition to gross profit on sales.

Branch houses are established to market goods and act as distributing points for goods sold in a given territory. Records kept at the branch are determined by the amount of authority delegated to the branch manager. Goods are usually billed to the branch at cost price. In the case of retail stores goods are billed at selling price to keep a closer control over the goods. The main office keeps an account with each branch which is charged for goods shipped to the branch and expenses paid for the branch, and credited for remittances from the branch.

Goods are shipped C.O.D. (cash on delivery) by local delivery express, by parcel post, by express, and by freight. The invoice price of the goods is collected when delivered in all cases except that of freight delivery. The railroad does not handle any money for the shipper, payment for the goods being collected through a bank. Local C.O.D. sales are handled as cash sales; in all other cases they are handled the same as the regular accounts receivable.

Instalment accounts are recorded so that it is possible to determine the gross profit on that portion of the sale price that is paid within the fiscal period. Approval sales are handled as regular sales and then credited to the customer if returned, except in the case of large amounts which should be recorded in a special Approval Sales account.

Ticket and coupon sales are recorded so as to show the liability of the seller for the undelivered merchandise or service.

ANALYSIS OF FINANCIAL STATEMENTS

CHAPTER XLII

PERCENTAGES AND OPERATING STATISTICS

Purpose. — In order that a business man may draw any intelligent conclusions regarding the results of his business operations, it is necessary for him to study very carefully his financial statements and observe the relationships between the various items contained therein. While there are many important items appearing in the operating statement, they do not mean much unless compared with other items. For instance, a net profit of $25,000 for the current year does not mean much unless it is compared with the amount invested in the business, the amount of sales, cost of sales, expenses, etc. The fact that this represents a return of 10% on the investment as compared with 12% for last year is much more significant. It is the purpose of this and the following chapter to present a few of the simpler methods of interpreting the statements so that the owner may know more about how his business is progressing.

Using his sales as a basis a business man frequently wants to know the cost of every item that goes to make up his sales total. The retailer and the wholesaler, because of the keen competition of to-day, are just as anxious to analyze their costs as is the manufacturer. The grocer wants to know what proportion of his sales goes for delivery expense, for clerk hire, for rent, etc., and how this compares with that of other firms in his line of business. The tailor, the baker, the produce merchant, and the dry goods merchant all want to know the same thing. In making their analysis business men usually use the *percentage basis* because this is the most equitable basis of comparison, due to the fact that the volume of business done by various firms differs so greatly.

Basis for Making Comparisons. — The basis for figuring many of the comparisons desired by business men is either the *sales price* of the goods or the turnover or *cost of sales*. Both are very valuable for certain purposes. The sales price basis is satisfactory when it is desired to know what proportion of the sales total has been used for expenses of various kinds. The cost of sales basis is not so liable to fluctuate and is, therefore, the more accurate when

it is desired to ascertain the return on investment in goods, etc. The fact that the sales price includes whatever profit there may be in the transactions must not be overlooked.

While both of these bases may be used, it is very important that the one selected should be followed consistently; otherwise, the comparative ratios are valueless. For instance, if gross profit figured on net sales one year shows 25% while in the year following it shows 34% figured on cost of sales, the percentages are valueless for comparative purposes. In comparing the various items in an operating statement, therefore, the same basis should be used throughout.

Operating Percentages Illustrated. — The following operating statement taken from the books of a neighborhood tailor shop illustrates the method of showing distribution of sales price on a percentage basis.

The Belmont Tailor Shop
Profit and Loss Statement for Year Ending December 31, 19--

			Per Cent of Sales
Net Sales		$7,761.34	100.00
Deduct--Cost of Goods Sold:			
Materials Used:			
Woolens	$1,722.38		22.19
Linings	542.51		6.99
Trimmings	270.83		3.49
Total	$2,535.72		32.67
Cost to Make	1,871.00		24.10
Cost of Goods Sold		4,406.72	56.77
Gross Profit on Sales		$3,354.62	43.23
Deduct--Operating Expenses:			
Salaries and Store Help	$1,178.01		15.18
Rent and Light	370.00		4.77
Office and Shop Supplies	145.00		1.87
Advertising	135.00		1.74
Telephone	73.00		.94
Depreciation of Furniture	35.00		.45
Miscellaneous Expenses	204.89		2.64
Total Operating Expenses		2,140.90	27.59
Net Profit for the Year		$1,213.72	15.64

In arriving at the percentages shown, each item is compared with the net sales for the year. For instance, the ratio of the first item, Woolens, amounting to $1,722.38, is found as follows: $1,722.38 ÷ $7,761.34 = .2219 or 22.19%. The remaining items are computed in the same way.

The amount of net sales is considered 100%, and the cost of goods sold, gross profit on sales, various operating expenses, and net profit are compared with the net sales. The details of the material accounts are not shown in this statement. The item "Making Cost" refers to the price paid for making garments which is done outside the shop on a contract basis. It is the custom in this shop to buy the material, do the cutting, and then send goods out to be made up. A statement of this kind is especially valuable as it enables the proprietor to compare his ratios with those of composite statements published in the trade magazines. This is not a standard form of statement but is used to illustrate a use of percentages.

Turnover Basis Illustrated. — If the cost of sales or turnover basis were used in the above instance, each item would be compared with the cost of sales, $4,406.72. The result is a larger percentage in each case. Some of these ratios, such as that for gross profit and net profit, are of value but others, such as ratio of operating expenses to turnover, have little significance. A statement of the figures on the cost of sales basis follows:

The Belmont Tailor Shop

Percentage Statement of Cost, Expenses, and Profit on the Cost of Sales Basis for the Year ending December 31, 19--

	Values	% Ratios
Woolens--Cost of stock used	$1,722.38	39.09
Linings--Cost of stock used	542.51	12.31
Trimmings--Cost of stock used	270.83	6.15
Cost to Make	1,871.00	42.45
Cost of Sales	$4,406.72	100.00
Gross Profit	$3,354.62	76.13
Salaries and Store Help	$1,178.01	26.73
Rent and Light	370.00	8.40
Office and Shop Supplies	145.00	3.29
Advertising	135.00	3.06
Telephone	73.00	1.66
Depreciation of Furniture	35.00	.80
Miscellaneous Expenses	204.89	4.65
Net Profit on Turnover	1,213.72	27.54

Percentages Applied to Sales Units. — An application of percentage ratios showing the proportion of direct cost, expenses, and profit in the sales price of an average priced suit of clothing or other unit is often quite useful and interesting to the proprietor. To illustrate, assume that it is desired to find how the sales price of a $50 suit of clothes is distributed. The proportions are

found by taking the percentage ratios based on net sales shown in the statement on page 375 and multiplying each by the sale price of the suit, $50. For instance, the ratio on the first item, cost of woolens used, is 22.19%. 22.19% of $50 is $11.095.

The Belmont Tailor Shop

Proportion of Direct Cost, Expenses and Profit on a $50 Suit of Clothing for the Year ended December 31, 19--

	Values	% Ratios
Woolens Cost	$11.095	22.19
Linings Cost	3.495	6.99
Trimmings Cost	1.745	3.49
Cost to Make	12.050	24.10
Salaries and Store Help	7.590	15.18
Rent and Light	2.385	4.77
Office and Shop Supplies	.935	1.87
Advertising	.870	1.74
Telephone	.470	.94
Depreciation of Furniture	.225	.45
Miscellaneous Expenses	1.320	2.64
Net Profit on Suit	7.820	15.64
Sale Price of Suit	$50.00	100.00

Balance Sheet Ratios and Percentages. — Percentage ratios are also a valuable aid in judging the financial condition of a company when applied to the balance sheet. The total assets amount, in itself, is not very significant, but the nature of the assets and the ratio of fixed to current items and of each to the total is very important. The same thing applies to liabilities. The per cent of each current asset to the total of the group and the per cent of each fixed asset to that total are also sometimes useful. The balance sheet of The Central Trading Company shown on page 379 shows the ratio of each asset and liability group to the total and each item in the group to the group total.

In addition to the percentages showing the proportions of the various asset and liability groups, the comparison of various items in the balance sheet with each other and with items in the profit and loss statement aid materially in determining the progress of the business. Attention is here called to just a few of these items:

(*a*) *Comparison of current assets and current liabilities.* — The difference between the current assets and current liabilities of a business is known as its working capital. It is obvious that the current liabilities should not exceed

the current assets; otherwise, the company has no working capital with which to liquidate its current liabilities as they fall due. When a balance sheet is submitted to a bank for credit purposes the margin between the current assets and current liabilities is given first consideration. The bank usually insists that the current assets be $2\frac{1}{2}$ or 3 times as much as the current liabilities. This is in order to allow for shrinkage in case of forced liquidation. In the illustration the current assets are $122,517.50 and the current liabilities $45,094. The ratio in this case is 2.7, indicating that the company has about $2.70 of current assets for each $1.00 in current liabilities. This is a favorable position as far as this comparison is concerned.

(*b*) *Ratio of total liabilities to net worth.* — The total liabilities represent the equity of outsiders in the assets of the business, while the net worth represents the equity of the stockholders or owners of the business. In the illustration the total liabilities $95,094 are about 44% of the total capital while the net worth of $120,366.75 is about 56%. As the stockholders have provided more than half the capital the condition would seem to be satisfactory.

(*c*) *Ratio of fixed assets to net worth.* — This ratio indicates what proportion of the net capital is tied up in fixed properties and what proportion is available for working capital. In the illustration the net fixed assets are $41,764 (fixed assets $91,764 — fixed liabilities $50,000) as compared with $120,366.75 net worth. If the tendency is to increase the fixed assets too rapidly the company is likely to become embarrassed on account of lack of working capital and may be obliged to seek outside capital.

(*d*) *Book value of capital stock.* — The book value of capital stock refers to the value of the net assets applicable to each share of stock as shown by the books. It is found by dividing the net worth of the corporation by the number of shares of stock outstanding. In this case the net worth is $120,366.75 and the number of shares of stock, assuming the par value to be $100 per share, is 1,000. Dividing $120,366.75 by 1,000 the book value is found to be $120.37 per share, which is about 20% above par value. The market price should bear some relation to the book value. The market price of stock, however, is determined more by its earning capacity, or the amount of dividends paid, than it is by the net assets back of the stock. If investors are furnished with a correct balance sheet from which the book value of the stock may be determined it should help determine whether the stock is a good investment. The book value of no par value stock is calculated in the same way as that for par value stock.

THE CENTRAL TRADING COMPANY

Balance Sheet, December 31, 19—

Assets

			% Ratios		% Ratios
Current Assets:					
Cash on Hand and in Bank		$16,268.00	13.28		
Notes Receivable		8,450.00	6.89		
Accounts Receivable	$60,435.00				
Less — Res. for Doubtful Accts.	895.50	59,539.50	48.60		
Merchandise Inventory		38,260.00	31.23		
Total Current Assets			100.00	$122,517.50	56.86
Fixed Assets:					
Land		$37,500.00	40.86		
Building	$56,000.00				
Less — Res. for Depreciation	7,000.00	49,000.00	53.40		
Office Equipment	$ 4,520.00				
Less — Res. for Depreciation	1,356.00	3,164.00	3.45		
Delivery Equipment	$ 5,250.00				
Less — Res. for Depreciation	3,150.00	2,100.00	2.29		
Total Fixed Assets			100.00	91,764.00	42.59
Deferred Charges:					
Insurance Prepaid		$ 400.00			
Taxes Prepaid		625.00			
Interest Prepaid on Notes Payable		154.25			
Total Deferred Charges				1,179.25	.55
Total Assets				$215,460.75	100.00

Liabilities and Capital

Current Liabilities:					
Accounts Payable		$18,234.00	40.44		
Notes Payable		25,000.00	55.44		
Salaries and Wages Accrued		1,235.00	2.74		
Interest Accrued on Mortgage Payable		625.00	1.38		
Total Current Liabilities			100.00	$ 45,094.00	20.93
Fixed Liabilities:					
Mortgage Payable				50,000.00	23.21
Total Liabilities				$ 95,094.00	44.14
Capital:					
Capital Stock		$100,000.00			
Surplus: Balance January 1, 19—	$ 4,146.25				
Net Profit for year	16,220.50	20,366.75			
Net Worth December 31, 19—				120,366.75	55.86
Total Liabilities and Capital				$215,460.75	100.00

Illustration — Statement of Balance Sheet Ratios

Operating Statement Ratios. — The profit and loss statement of the Central Trading Co. is presented on page 381 with percentage statistics based on *net sales*. Attention is called to the following important items in this statement with relation not only to other items in this statement but also to items in the balance sheet shown on page 379:

(*a*) Net Profit for the year $16,220.50.
Based on net sales the ratio is 4.30%.
Based on cost of sales the ratio is 5.34% ($16,220.50 ÷ $303,779.25).
Based on capital investment at the beginning of the year the ratio is 15.57% ($16,220.50 ÷ $104,146.25).

Thus it is seen that, while the net return on the volume of business is very small, the return on capital invested is good.

(*b*) Merchandise turnover for the year is $303,779.25.
The rate of turnover is 7.5 times which is found by dividing the total turnover by the average inventory:

$$\frac{\$303,779.25}{(\$42,540 + \$38,260) \div 2}$$

This is a very important item and in this case indicates an active turnover of stock and accounts for the satisfactory return on investment on such a small sales margin.

Stock turnover as explained in Chapter XIII refers to the total cost of goods that have been sold during the period and thus turned into cash, notes receivable, accounts receivable, etc. The rate of turnover refers to the number of times that the amount of goods a merchant carries in stock at any one time has been sold out during the period. For instance, if a fruit and vegetable vendor goes into the market in the morning and stocks up with his wares and at the close of the day has sold out he has turned over his stock once. If he does this five days in a week his rate of turnover for the week is five. In much the same way small provision dealers have a high rate of turnover. Most businesses, however, are buying and selling continually and the problem of figuring the turnover is not so simple. An average figure must be used, the total cost of sales being divided by the average inventory as indicated above.

(*c*) *Accounts Receivable to Sales ratio.* — The purpose of this ratio is to indicate the proportion of sales not collected, and is found by comparing the total amount owing by customers with the net sales. In the Central Trading Company statements the net sales are $378,230 while the Accounts Receivable

THE CENTRAL TRADING COMPANY

Profit and Loss Statement for Year ending December 31, 19—

				Per Cent of Sales
Gross Sales		$381,850.00		
Less—Returns and Allowances		3,620.00		
Net Sales			$378,230.00	100.00
Deduct — Cost of Goods Sold:				
Inventory, December 31, 19—		$ 42,540.00		
Gross Purchases	$290,325.00			
Less — Returns and Allowances	2,150.00			
Net Purchases		288,175.00		
Freight Inward		5,124.00		
Purchasing Expenses		6,200.25		
Total Cost of Goods		$342,039.25		
Less—Inventory, December 31, 19—		38,260.00		
Cost of Goods Sold			303,779.25	80.31
Gross Profit on Sales			$ 74,450.75	19.69
Deduct — Operating Expenses:				
Selling Expenses		$ 22,375.60		
General Administrative Expenses		18,240.15		
Shipping and Delivery Expenses		11,800.75		
Credit and Collection Expenses		2,025.82		
Maintenance of Real Estate		3,850.20		
Total Operating Expenses			58,292.52	15.41
Net Profit from Operations			$ 16,158.23	4.28
Add — Other Income:				
Interest on Bank Balance		$ 286.00		
Interest on Notes Receivable		215.25		
Purchases Discount		3,828.00		
Rent Income		2,500.00		
Total Other Income			6,829.25	1.81
Total Income			$ 22,987.48	6.09
Deduct — Other Expenses:				
Interest on Mortgage Payable		$ 2,500.00		
Interest on Notes Payable		1,240.40		
Provision for Doubtful Accounts		3,026.58		
Total Other Expenses			6,766.98	1.79
Net Profit for the Year			$ 16,220.50	4.30

Illustration — Statement with Operating Ratios

are $60,435, or about one-sixth of this amount. Assuming that the sales are spread evenly over the entire twelve months, then one-sixth of twelve or two

months' sales are not collected. This may be favorable or unfavorable depending upon the business and selling terms.

(*d*) *Accounts Payable to Purchases ratio.* — This indicates the proportion of purchases not paid for. The purchases amount to $288,175 while the amount due creditors on open account is $18,234 or about one-sixteenth of the total purchases, or less than one month's purchases outstanding. This indicates a tendency to take cash discounts and pay promptly, which is also shown by the large amount of purchases discount shown in the statement, $3,828 averaging 1.3% on total net purchases.

(*e*) *Distribution of Sales.* — The percentage column in the profit and loss statement shows each dollar of sales to be distributed as follows:

Cost of goods	$ .8031
Operating Expenses	.1541
Profit	.0428
Total	$1.00

The ratios and comparisons shown above are suggestive only. Many others may be used but require a more advanced training in accounting than this course offers. In order to secure the most value from such data a thorough knowledge of business and accounting is required.

EXERCISE 42-a

Referring to the profit and loss statement, page 381, of the Central Trading Company, prepare the following percentage statistics and analysis:

(*a*) A statement showing the ratio of each of the items in the operating expense group to net sales.

(*b*) A statement showing the ratio of each of the items in the operating expense group to the group total.

(*c*) Assuming that this concern sells a standard line of products, set up a schedule showing the proportion of direct cost, operating expense, and profit from operation on an article selling for $25. Use a form similar to that shown on page 377.

EXERCISE 42-b

The following items are taken from the books of D. S. Duncan for the year ending December 31, 1926:

Inventory December 31, 1925, $95,000; Inventory December 31, 1926, $120,000; Gross Purchases, $230,000; Purchase Returns and Allowances, $2,500; Gross Sales, $310,000; Sales Returns and Allowances, $3,260; Income from Sale of Waste, $225; Interest on Mortgage Payable, $675; Interest on Notes Payable, $510; Interest on Bank Deposits, $95; Loss on Bad Accounts, $1,850; Freight Inward, $2,480; Main-

tenance of Real Estate, $3,500; Purchasing Expenses, $5,825; General Administrative Expenses, $12,500; Delivery Expenses, $9,360; Selling Expenses, $48,560; Purchase Discounts, $5,345; D. S. Duncan, Capital December 31, 1925, $165,000.

Required:

(*a*) Profit and loss statement set up in standard form with a column for percentage statistics based on net sales.

(*b*) A statement showing the rate of merchandise turnover for the year. Would a bank be likely to make a loan to Duncan on the basis of this ratio?

(*c*) Show how the rate of net profit based on turnover or cost of sales compares with the rate of return on the capital investment.

QUESTIONS FOR DISCUSSION

1. Is it sufficient for a business man to know that his books have been well kept, that they are in balance, that the bookkeeper presents him with a profit and loss statement showing a net profit of $24,350, and a balance sheet showing his net capital to be $150,000? If not, what other information does he need?

2. Why are percentages used in making comparisons in business?

3. What items does the merchant include in his "cost of sales"?

4. Name the most common bases for figuring comparisons in the profit and loss statement. Which is considered the more accurate?

5. What principle should be followed in selecting a basis of comparison?

6. What is meant by the term "turnover"?

7. Explain in what way percentage statistics may be applied to sales units.

8. What is the "working capital" of a business? What items in the balance sheet are used to arrive at the working capital? Why is this item so important?

9. What information results from comparing total liabilities with net worth?

10. What does the ratio of fixed assets to net worth indicate?

11. What is meant by the "book value" of a share of stock in a corporation and of what value is this information?

12. You are offered 100 shares of stock in a corporation at $110 per share (par $100). You ask for a balance sheet of the company and find that there are 2,000 shares of stock outstanding and that the net worth of the company is $246,000. Providing the items in the balance sheet are properly stated and assets are properly valued, would you consider this a good purchase?

13. Name the more important ratios that should receive attention in the profit and loss statement.

14. Which is the more important to the proprietor, the ratio of net profit to net sales or the ratio of net profit to capital invested?

15. What does it indicate when the rate of net profit on investment is small and the rate of profit on net sales is high? Suppose conditions were reversed, would your answer be the same?

CHAPTER XLIII

COMPARATIVE FINANCIAL STATEMENTS

Value of Comparative Statements. — In the last chapter comparisons and percentage ratios of various items in the financial statements were discussed and illustrated, and it was shown how by this means very valuable information regarding the progress of the business could be presented to the management for their guidance in determining policies for carrying on their business during the coming year. In some respects much more valuable information may be found by comparing the items in the statements for one year with those of the previous year or for several years. This shows the trend of affairs much more clearly than by taking simply the items for one year which may or may not represent normal conditions. The data for one year should not be depended upon entirely to show the progress of the business. For this reason business men request their bookkeepers to prepare comparative statements, showing in parallel columns the items for two or more years, so that the increases and decreases in the items for the various periods may be more clearly set forth and any items showing unusual changes may be investigated.

Banks frequently require not only comparative statements but also a detailed analysis of such items as accounts receivable and accounts payable when their customers apply to them for a loan.

The Comparative Balance Sheet. — On page 385 is shown a comparative balance sheet of the Walton Trading Company showing the financial position at the end of the years 1926 and 1927. This form shows both percentages of the various assets and liabilities to the totals and the increases and decreases of the detailed items. The increases and decreases are shown in the same column. When this form is used the decreases are starred or shown in red. In the illustration those items starred represent decreases. Separate columns may be used for increases and decreases if desired. Instead of being deducted from the assets, which is the preferable form, the reserves for depreciation are shown on the liability side of the balance sheet. This is for convenience in setting up the statement. The book value only of the fixed assets and accounts receivable may be shown if desired, in which case the reserves do not appear on the statement at all.

THE WALTON TRADING COMPANY

Comparative Balance Sheet, December 31, 1926 and 1927

	1926		1927		Increase or Decrease*
	Amount	Per Cent	Amount	Per Cent	
ASSETS					
Current Assets:					
Cash	1,600 00	1 3	2,400 00	1 7	800 00
Notes Receivable	4,250 00	3 3	3,640 00	2 6	610 00*
Accounts Receivable	42,500 00	33 2	48,500 00	34 9	6,000 00
Merchandise Inventory (Cost)	36,000 00	28 1	39,200 00	28 2	3,200 00
Total Current Assets	84,350 00	65 9	93,740 00	67 4	9,390 00
Fixed Assets:					
Land (Cost)	15,000 00	11 7	15,000 00	10 8	
Building (Cost)	24,000 00	18 8	26,000 00	18 7	2,000 00
Office Equipment (Cost)	1,820 00	1 4	2,100 00	1 5	280 00
Delivery Equipment (Cost)	2,400 00	1 9	1,800 00	1 3	600 00*
Total Fixed Assets	43,220 00	33 8	44,900 00	32 3	1,680 00
Deferred Charges:					
Insurance Prepaid	150 00	1	190 00	1	40 00
Taxes Prepaid	200 00	2	224 00	2	24 00
Total Deferred Charges	350 00	3	414 00	3	64 00
Total Assets	127,920 00	100 0	139,054 00	100 0	11,134 00
LIABILITIES AND CAPITAL					
Current Liabilities:					
Notes Payable	20,000 00	15 6	15,000 00	10 8	5,000 00*
Accounts Payable	24,560 00	19 2	26,250 00	18 9	1,690 00
Salaries Accrued	250 00	2	275 00	2	25 00
Total Current Liabilities	44,810 00	35 0	41,525 00	29 9	3 285 00*
Fixed Liabilities:					
Mortgages Payable	20,000 00	15 6	20,000 00	14 4	
Reserves:					
Depreciation of Building	2,950 00	2 3	3,430 00	2 5	480 00
Depreciation of Office Equipment	650 00	5	832 00	6	182 00
Depreciation of Delivery Equipment	600 00	5	1,000 00	7	400 00
Loss on Bad Accounts	850 00	7	960 00	7	110 00
Total Reserves	5,050 00	4 0	6,222 00	4 5	1,172 00
Total Liabilities and Reserves	69,860 00	54 6	67,747 00	48 8	2,113 00*
Capital:					
Capital Stock	50,000 00	39 1	50,000 00	35 9	
Surplus	8,060 00	6 3	21,307 00	15 3	13,247 00
Total Capital	58,060 00	45 4	71,307 00	51 2	13,247 00
Total Liabilities, Capital and Reserves	127,920 00	100 0	139,054 00	100 0	11,134 00

The current assets have all increased with the exception of notes receivable. Business having increased during the year these increases are normal.

The changes in the cost of fixed assets have not been great. The building cost has been increased $2,000 due to permanent improvements and extensions which are properly charged to the asset account. Additional office equipment has been purchased. Delivery equipment has been decreased due to the disposal of a small truck carried on the books at $600.

The decrease in current liabilities is due to the decrease in the amount of notes payable outstanding. These notes represent very largely bank loans, a number of which have been liquidated. The reserve items have been increased at normal rates, 2% being provided on building, 10% on office equipment, 20% on delivery equipment, and 2% for bad debts.

The total liabilities show a net decrease of $2,113 while the total assets show an increase of $11,134 which, added together, show an increase in net capital of $13,247.

Attention is called to the fact that the ratio of current assets has increased slightly while that of fixed assets has decreased, which shows a tendency to keep the working capital intact especially in view of the fact that current liabilities ratio has decreased from 35% to 29.9%.

Comparative Profit and Loss Statement. — The form of profit and loss statement for the Walton Trading Company shown on page 387 has the advantage of showing not only percentages based on sales for each of the years 1926 and 1927, but also the increases and decreases of the various items. More significant than the increase or decrease in dollars as shown in the column to the right, however, are the increases or decreases in per cent which may be noted by comparing the per cent columns for the two years.

The net sales have increased about 50% while the ratios of cost of sales and gross profit to sales remain about the same, there being a slight decrease in ratio of cost of sales which increases the ratio of gross profit. Therefore, while there is an increase in gross profit of $14,464 this figure is not so important when the percentage ratios are taken into consideration.

While the operating expenses have increased $5,262, it is interesting to note that the ratio of operating expenses has decreased from 32.4% in 1926 to 28% in 1927. This, with the slight increase in gross profit, has increased the ratio of net income from operations from 9.3% in 1926 to 16.5% in 1927. This has been due largely to increased turnover without a corresponding increase in expenses. For instance, while the details of cost of goods sold are not shown, by referring to the balance sheet on page 385 the inventory at the close of 1926

is found to be $36,000. Assuming the inventory at the beginning of that year to be about the same figure, then, by dividing this amount into the total turnover of $36,125 shown in the profit and loss statement the rate of turnover is found to be 1. By taking the inventories at the beginning and end of 1927 and averaging them the result is $37,600 which, compared with the total turnover for 1927, $50,286, shows a rate of turnover of 1.3.

THE WALTON TRADING COMPANY

Comparative Profit and Loss Statement for Years Ended December 31, 1926 and 1927

	1926		1927		Increase or Decrease*
	Amount	Per Cent	Amount	Per Cent	
Net Sales	62,000 00	100 0	90,625 00	100 0	28,625 00
Deduct — Cost of Goods Sold:	36,125 00	58 3	50,286 00	55 5	14,161 00
Gross Profit on Sales	25,875 00	41 7	40,339 00	44 5	14,464 00
Deduct — Operating Expenses:					
Salaries and Wages	15,400 00	24 8	18,600 00	20 5	3,200 00
Advertising	2,200 00	3 5	3,400 00	3 8	1,200 00
Delivery Expenses	425 00	7	710 00	8	285 00
Office Expenses	380 00	7	487 00	5	107 00
Insurance	235 00	4	350 00	4	115 00
Taxes	90 00	1	100 00	1	10 00
Depreciation of Building	420 00	7	480 00	5	60 00
Auditing	150 00	2	225 00	3	75 00
Light and Heat	360 00	6	460 00	5	100 00
General Expenses	435 00	7	545 00	6	110 00
Total Operating Expenses	20,095 00	32 4	25,357 00	28 0	5,262 00
Net Income from Operations	5,780 00	9 3	14,982 00	16 5	9,202 00
Add — Other Income:					
Purchases Discount	392 00	6	675 00	7	283 00
Interest on Notes Receivable	80 00	1	70 00	1	10 00*
Interest on Bank Balance	54 00	1	40 00	1	14 00*
Total Other Income	526 00	8	785 00	9	259 00
Total Income	6,306 00	10 1	15,767 00	17 4	9,461 00
Deduct — Other Expenses:					
Sales Discount	725 00	1 2	685 00	8	40 00*
Interest on Notes Payable	700 00	1 1	550 00	6	150 00*
Interest on Mortgage	450 00	7	1,200 00	1 3	750 00
Loss on Bad Debts	105 00	2	85 00	1	20 00*
Total Other Expenses	1,980 00	3 2	2,520 00	2 8	540 00
Net Profit	4,326 00	6 9	13,247 00	14 6	8,921 00

The ratio of other income has increased slightly due to more cash discounts having been taken. The ratio of other expenses has decreased slightly so that the final ratio of net profit to sales is found to be 14.6% as compared with 6.9% for the previous year.

Comparing the net profit for each of the two years with the capital investment at the beginning of the year, the ratio for 1926 is found to be 8.05% ($4,326 ÷ $53,734) while that for 1927 is 22.8% ($13,247 ÷ $58,060).

EXERCISE 43-a

On June 30, 19— the assets and liabilities of Charles E. Bowen were as follows: Cash, $3,400; Notes Receivable, $2,500; Accounts Receivable, $2,670; Merchandise Inventory, $3,200; Furniture and Office Equipment, $1,820; Delivery Equipment, $2,400; Insurance Prepaid, $475; Stationery on Hand, $25; Notes Payable, $1,500; Accounts Payable, $2,640.

On December 31 of the same year Mr. Bowen's assets and liabilities were as follows: Cash, $2,460; Notes Receivable, $2,400; Accounts Receivable, $3,210; Merchandise Inventory, $3,800; Furniture and Office Equipment, $2,150; Delivery Equipment, $1,800; Insurance Prepaid, $560; Stationery on Hand, $50; Real Estate, $7,500; Notes Payable, $1,700; Accounts Payable, $2,200; Mortgage Payable, $4,000; Taxes Accrued, $120.

Required:

Prepare a comparative balance sheet with percentages and increases and decreases as shown on page 385.

EXERCISE 43-b

The following are the post-closing trial balances of The Roxbury Merchandising Company at the end of last year and this year:

	(Last Year) December 31,19—	(This Year) December 31, 19—
Cash	$ 9,850.00	$ 8,520.00
Notes Receivable	5,800.00	4,200.00
Accounts Receivable	45,535.00	48,540.00
Merchandise Inventory	68,540.00	65,350.00
Organization Expenses	2,400.00	2,000.00
Insurance Prepaid	1,200.00	800.00
Supplies on Hand	450.00	650.00
Land and Buildings	145,000.00	140,000.00
Machinery and Equipment	52,540.00	60,450.00
Office Equipment	4,800.00	5,430.00
Investments	20,000.00	25,000.00
Goodwill	30,000.00	25,000.00

EXERCISE 43-b (Cont.)

Notes Payable	$10,000.00		$15,000.00	
Accounts Payable	28,400.00		38,320.00	
Interest Accrued on Mortgage Payable	1,500.00		1,500.00	
Salaries and Wages Accrued	1,200.00		1,325.00	
Dividends Payable	12,000.00			
Mortgage Payable	75,000.00		75,000.00	
Reserve for Loss on Bad Debts	5,475.00		5,860.00	
Reserve for Depreciation on Buildings	18,500.00		20,500.00	
Reserve for Depreciation on Machinery and Equipment	8,579.00		12,450.00	
Reserve for Depreciation on Office Equipment	865.00		1,870.00	
Capital Stock	200,000.00		200,000.00	
Surplus	24,596.00		14,115.00	
	$386,115.00	$386,115.00	$385,940.00	$385,940.00

Required:

Comparative balance sheet showing percentage ratios for each year and increases and decreases for the period. Follow form on page 385.

EXERCISE 43-c

The following are the trial balances of S. W. Rogers for the last two years:

	(Last Year)		(This Year)	
Cash	$ 1,400.00		$ 2,142.20	
Accounts Receivable	1,762.10		1,540.20	
Notes Receivable	650.00		1,400.00	
Real Estate	10,000.00		10,000.00	
Office Equipment	240.00		350.00	
Notes Payable		$ 1,000.00		$ 500.00
Accounts Payable		1,754.00		1,630.00
Mortgage Payable		5,000.00		5,000.00
Inventory (at beginning)	4,500.00		5,345.00	
Purchases	5,425.00		6,250.00	
Sales		6,870.00		14,620.00
Freight Inward	74.10		95.60	
General Administrative Expenses	213.20		610.30	
Maintenance of Real Estate	65.30		175.20	
Selling Expenses	239.06		916.45	

EXERCISE 43-c (Cont.)

Purchases Discount		$ 54.50		$ 145.20
Sales Discount	$ 112.54		$ 224.45	
Interest Income		21.40		48.40
Interest Expense	18.60		394.20	
S. W. Rogers, Capital		10,000.00		10,000.00
S. W. Rogers, Drawings			2,500.00	
	$24,699.90	$24,699.90	$31,943.60	$31,943.60

Inventory This Year — $5,625.

Required:

(*a*) Comparative balance sheet with percentage ratios.

(*b*) Comparative profit and loss statement with ratios.

(*c*) Compute the following additional statistics:

1. Working capital ratio
2. Rate of turnover
3. Ratio of current to fixed assets
4. Rate of return on investment.

QUESTIONS FOR DISCUSSION

1. What is meant by a comparative statement?

2. Why do business men prefer to have their bookkeepers furnish them with comparative statements?

3. What information may be secured from a comparative statement that cannot be found on an analyzed annual statement?

4. Which are more important in a comparative statement — increases and decreases in *dollar-* or in *percentage ratios?* Why?

5. Suggest a different form of comparative balance sheet from that shown on page 385.

6. What do fluctuations in fixed asset accounts usually signify (*a*) when increased (*b*) when decreased?

7. Why should the ratio between current and fixed assets to total assets be noted?

8. Explain why in the profit and loss statement shown on page 387 net income from operations has increased over 250%, while sales have increased only about 50%.

9. The two largest items of expense in the Walton Trading Co. profit and loss statement are Salaries and Advertising. Have they increased or decreased?

10. Has the working capital ratio of the Walton Trading Co. increased or decreased during the year?

SUMMARY OF CHAPTERS XLII AND XLIII

It is desirable for business men to know the proportions of the various elements making up their sales total. The percentage basis is used for this purpose. Comparisons may be based on *net sales* or on *cost of sales*. Each basis is satisfactory if used consistently.

Percentages may be applied to sales units by multiplying each percentage ratio, based on average net sales as shown in the operating statement, by the sales price per unit.

Percentage ratios may be applied also to the balance sheet by finding the ratio of fixed to current assets, ratio of each asset or liability to the group totals, etc.

Comparisons between items in the balance sheet are made as follows: current assets to current liabilities, to determine the working capital ratio; total liabilities to net worth, to determine the source of capital; fixed assets to net worth, to determine the proportion of capital invested in fixed properties, etc. Other items of value are the book value of capital stock; merchandise turnover, to show movement of stock; return on invested capital, and ratio of profits to sales; accounts receivable to sales ratio, to indicate the trend of collections; accounts payable to purchases, to indicate the promptness with which bills are paid, etc.

Other valuable information may be secured by comparing the items in the financial statements of one year with those of the previous year and noting the various increases and decreases. This is done by means of comparative statements showing in parallel columns the amounts for the two or more years with columns for increases and decreases. The increases and decreases show the trend of the business. Percentages are also shown, percentage increases and decreases being more important than dollar increases and decreases.

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